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Federal Estate and Gift Taxes

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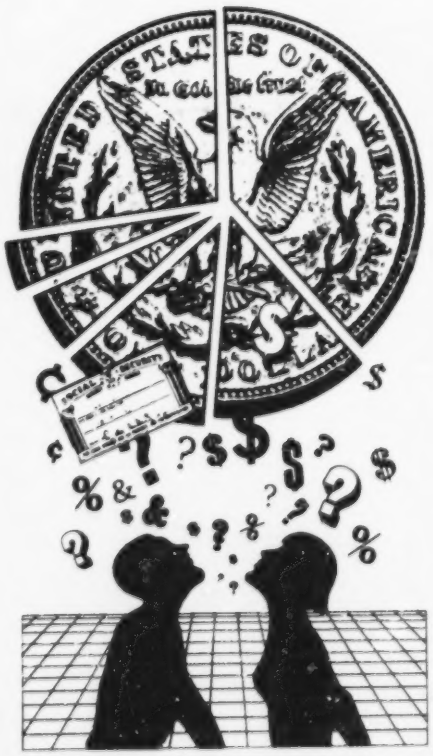

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Introduction

This publication discusses the Internal Revenue Code provisions dealing with estate, gift, and generation-skipping transfer taxes. Each of these taxes is discussed separately. This publication also contains a section that discusses requests for factors, computations, and rulings from the Internal Revenue Service.

Estate Tax

This section discusses the federal estate tax provisions that apply to the estate of an individual who died in 1981 or in a later year. If you are filing an estate tax return for the estate of an individual who died after 1981, be sure to read the general provisions and those that are identified by the phrase **After 1981.**

Federal estate tax applies to the transfer of property at death. The estate of a person who died (the decedent) is liable for the tax on the entire taxable estate. However, the beneficiaries of the estate may have to pay the tax if the estate does not pay it when it is due. Each beneficiary's liability is limited to the value of the part of the estate he or she received.

Generally, the value of the estate is determined on one of two dates: the date of death or, if the alternate valuation method is used, 6 months after the date of death. The date at the location of a person's domicile (legal residence) at the time of death determines the date of death. A person's domicile also determines where the estate tax return must be filed.

Decedent's status. A decedent's status as a U.S. citizen or resident or as a nonresident noncitizen on the date of death determines the property to be included in the estate, the requirements for filing a return, and the form that must be filed. See *Gross Estate* for information on specific types of property to be included in the estate, and *The Estate Tax Return* for information on the filing requirements.

Citizen or resident. If a person is a citizen or resident of the United States at the time of death, the value of his or her entire estate is subject to estate tax. This rule applies regardless of where the individual's property is located. The term "United States," for this purpose, does not include U.S. possessions or territories.

For estate tax, a ***resident*** is someone who had a domicile in the United States at the time of death. A person acquires a domicile in a place by living there, for even a brief period of time, with no present intention of moving from that place.

It is possible for someone to establish a domicile even if he or she is subject to deportation. Therefore, a person who is in the United States illegally and who lives here until death may be considered a resident for estate tax purposes. A nonimmigrant alien holding a "G–4" visa can also establish a domicile in the United States and is treated as a resident if he or she intended to stay indefinitely in the United States.

Nonresident noncitizens. For a nonresident who is not a citizen of the United States, only the value of his or her property that is located in the United States at the time of death is subject to the estate tax. If a person is a resident of any U.S. possession and is a U.S. citizen only because of birth, residence, or citizenship in a possession, he or she is considered a nonresident noncitizen, for estate tax purposes. See *Estates of Nonresident Noncitizens*, discussed later.

For a U.S. citizen who became an expatriate within 10 years of death, property subject to estate tax is limited to property located in the United States and certain foreign corporation stock. See *Expatriation to Avoid Tax*, discussed later.

The Estate Tax Return

Filing the Return

As the executor of an estate, you must file any required returns relating to the decedent. The term ***executor,*** as used in this publication, includes an executor, executrix, administrator, or administratrix of an estate. If there is no executor appointed, qualified, and acting within the United States, the term includes any person in actual or constructive possession of any of the decedent's property located in the United States.

If you are unable to make a complete return for any property interest in the gross estate, you must include on the return the name of everyone holding a legal or beneficial interest in that property and furnish a description of the property. If notified by the district director, anyone holding legal or beneficial interest in this property must file a return for that part of the gross estate.

Citizens or residents. As the executor of an estate of a U.S. citizen or resident who died during 1981, you must file an estate tax return if the value of the gross estate at the date of death was more than $175,000.

After 1981. If a person dies after 1981, you must file a return if the gross estate is more than the amounts indicated below.

Year of Death	Gross Estate More Than
1982	$225,000
1983	$275,000
1984	$325,000
1985	$400,000
1986	$500,000
1987 and later	$600,000

These amounts are reduced by the total amount of adjusted taxable gifts made after 1976 (other than those gifts included in the decedent's estate), and the total amount allowed as a specific exemption for gifts made after September 8, 1976, and before 1977.

If a return must be filed, use Form 706, *United States Estate Tax Return*, that applies for the year of the decedent's death. The return is due 9 months after the date of death unless an extension of time for filing has been granted.

File the return with the Internal Revenue Service Center for the state in which the decedent was domiciled at the time of death. See the instructions for Form 706 for more information about filing.

Nonresident noncitizen. If the decedent was neither a resident nor a citizen of the United States, file Form 706NA, *United States Estate Tax Return, Estate of nonresident not a citizen of the United States,* if the value of the gross estate located in the United States is more than $60,000. This amount is reduced in the same manner as for a citizen of the United States.

This return is due 9 months after the date of death unless an extension is granted. File the return with the Internal Revenue Service Center, Philadelphia, PA 19255. See the instructions for Form 706NA for more information about filing.

Extension of Time for Filing

A reasonable extension of time to file the estate tax return, or related statements or documents, may be granted if it is impossible or impractical for you to complete the return within 9 months after the date of death.

The extension may not be for more than 6 months unless the executor is abroad.

Note. An extension of time to file does not extend the time to pay. You must include payment for the amount of the estimated estate tax at the time you request an extension of time to file.

Form to use. To request an extension of time to file, use Form 4768, *Application for Extension of Time to File U.S. Estate Tax Return and/or Pay Estate Tax.* File two copies of Form 4768 if you are requesting ***only*** an extension of time to file. If you are ***also*** requesting an extension to pay the tax, file four copies of Form 4768.

When to file. You must file Form 4768 early enough to permit the Internal Revenue Service to consider the application and reply before the estate tax due date.

Where to file. File the application with the Internal Revenue Service office where the estate tax return will be filed.

Information needed. Include a written statement with the application, showing why it is impossible or impractical for you to file a reasonably complete return by the due date.

Penalties. There is a penalty for failure to file an estate tax return when due (including any extensions of time for filing). A penalty of 5% per month, up to 25%, will be added to the tax required to be shown on the return, unless you show reasonable cause. The amount of the penalty for failure to file will be reduced by the amount of any penalty for failure to pay the tax shown on the return, explained later, for any month to which both penalties apply.

Paying the Tax

As an executor, you must pay the estate tax when the return is due. An extension of time for filing the return does not extend the due date for paying the tax. However, you may be allowed additional time to pay the tax if you can show reasonable cause or if the estate consists of certain kinds of property. These extensions of time for paying the tax are discussed later.

You must pay the entire estate tax, even if some of the property of the gross estate is not in your possession. If you are the executor because no other person was appointed, qualified, and acting within the United States, your tax liability is limited to the value of the property in your possession.

See *Executors and Administrators,* discussed later, for more information on the liability for paying the tax.

Extension of Time for Paying

There are provisions that allow additional time for paying the estate tax. The usual extension of time to pay is up to 12 months from the date the payment is due. The Internal Revenue Service, however, may extend the time for payment for up to 10 years. These extensions will be allowed if you can show ***reasonable cause.*** When you apply show why it is impossible or impractical for you to pay the full amount of the tax on the due date.

Reasonable cause. The following illustrate reasonable cause.

1) An estate includes enough liquid assets (cash or assets readily convertible to cash) to pay the estate tax when normally due. However, the liquid assets are located in several jurisdictions and are not within your immediate control. Thus, you cannot readily collect all the assets, even when you exercise due diligence.
2) Most of an estate's assets consist of rights to receive payments in the future. Examples of these assets include annuities, copyright royalties, contingent fees, and accounts receivable. These assets do not provide enough cash to pay the estate tax due, and the estate cannot borrow against these assets without causing a loss to the estate.
3) An estate includes a claim to substantial assets that cannot be collected without a lawsuit. Thus, the amount of the gross estate cannot be determined when the tax is due.
4) You have made a reasonable effort to convert the decedent's assets (other than an interest in a closely held business as discussed later) into cash. But the estate would have to borrow at an interest rate higher than generally available to have enough funds to:
   a) Pay the estate tax when due,
   b) Provide a reasonable allowance for the decedent's surviving spouse and dependent children while the estate is being administered, and
   c) Satisfy claims against the estate that are due and payable.

Form to use. Use Form 4768 to request an extension of time to pay the estate tax . Include a written statement explaining in detail why it is impossible or impractical for you to pay the full amount of the estate tax by the due date.

File two copies of Form 4768 if you are requesting ***only*** an extension of time to pay the tax. If you are ***also*** requesting an extension of time to file the return, file four copies of Form 4768. For more information see *Extension of Time for Filing.*

Paying the tax. Generally, additional time is granted for paying the amount of the cash shortage. However, you must pay the rest of the estate tax that is due when you file the application.

Note. An extension of time to pay does not extend the time to file. It also does not relieve the estate from liability for paying interest on the balance due during the period of extension.

Appeal. If your request for an extension of time is denied, you may make a written appeal to the regional commissioner. The appeal must be made within 10 days after the denial is mailed to you.

Deficiency. The Service might find that an amount is still due after you have paid the tax. If so, you may be able to extend the time to pay this deficiency for up to 4 years from the date that was fixed for payment. You must show reasonable cause to get this extension. The deficiency must not be due to negligence, intentional disregard for rules and regulations, or fraud.

Penalties. If you do not pay the tax shown to be due on the return and you do not show reasonable cause, you will be charged a penalty of one-half of 1% a month (up to 25%) on the unpaid amount. There is a similar penalty for failing to pay a tax deficiency within 10 days from the date of notice, unless you show reasonable cause.

Reversionary or remainder interest. If the gross estate includes the value of a reversionary or remainder interest, you may elect to postpone the payment of the tax attributable to that interest until 6 months after the preceding interests in the property have ended.

If, at the end of this 6-month period, you show reasonable cause, the Service may grant additional time of up to 3 years for payment of the tax attributable to these interests.

Installment Payments—Closely Held Business

If the gross estate includes an interest in a closely held business, you may be able to elect to pay the estate tax on that interest in installments. For the estate to qualify for the election, the decedent must have been a U.S. citizen or resident at the time of death.

If you are the executor of an estate of a person who died in 1981, you may make the election under one of the two methods described below.

If you are the executor of an estate of a person who dies after 1981, there is only one method under which you may elect installment payments. See the discussion under *After 1981*.

Method one. Under this method, you may pay the estate tax on the interest in the closely held business in up to 10 equal yearly installments. The first installment is due by the regular due date for paying the estate tax. The remaining installments are due annually by the date one year after the due date of the preceding installment.

File the election with the district director for the Internal Revenue Service district where the return will be filed. Make the election by the due date for filing the return (including extensions). The election may be in the form of a letter, and it must contain the following information:

1) The decedent's name and identification number as they will appear on the estate tax return,
2) The amount of tax to be paid in installments,
3) The total number of installments (including the first installment),
4) The properties qualifying as an interest in a closely held business. These should be listed and identified by the schedule and item number at which they appear on the estate tax return, and
5) The reasons you think the estate qualifies for installment payments.

Attach a copy of this election to the estate tax return when you file it.

If you make the election and the Service has already granted an extension of time for filing, you will be considered to have made a timely filed request for an extension of time to pay the first installment if you pay the first installment when you file the estate tax return (within the extended filing period).

Interest in a closely held business, for purposes of this method, includes:

1) An interest as a proprietor in a trade or business carried on as a proprietorship,
2) An interest as a partner in a partnership of not more than 10 partners, or in which the decedent owned at least 20% of the capital, and
3) Ownership of stock in a corporation that has not more than 10 shareholders, or in which the decedent owned at least 20% of the voting stock.

The partnership or corporation must be carrying on a trade or business at the time of the decedent's death.

A ***business*** can be a manufacturing, mercantile, or service enterprise as distinguished from management of investment assets. The ownership of royalty interests or the grouping of income-producing assets is not a business.

Percentage requirements. This method is available only if the value of the interest in the closely held business is more than 35% of the value of the gross estate or 50% of the taxable estate of the decedent.

For determining these percentages, the value of an interest in a proprietorship is the net amount a willing buyer would pay for that interest and not the total value of the assets of the proprietorship.

If you as executor elect the reduced special-use valuation for real property, you must also use that valuation to decide if the percentage tests are satisfied. See *Special Farm or Other Closely Held Business Real Property Valuation*, discussed later.

If a decedent had an interest in two or more closely held businesses, they are treated as a single closely held business only if more than 50% of the total value of each separate business is included in the estate.

Deficiencies. If you did not elect this installment payment method, you cannot elect it for any deficiencies that may be assessed at a later date. If you elected this method, the deficiency is prorated to the installments. However, the deficiency is not prorated if it is due to negligence, intentional disregard for rules and regulations, or fraud with intent to evade taxes.

Protective election. If the estate does not meet the percentage requirements based on the values shown on the return, or if no estate tax is due, you may make a protective election. This election allows you to use method one, if the values as finally determined meet the percentage requirements. The election must be made by the due date of the return and must state that it is a protective election.

If the requirements are met, any unpaid estate tax, including a deficiency, that is attributable to an interest in a closely held business may be paid in installments. The maximum amount qualifying will be payable in 10 equal annual installments, unless the protective election indicates a different amount or different number of installments. The first installment is due on the regular due date of the estate tax return. The prorated amount of tax for the first installment and any other installment date that has passed must be paid upon receipt of notice and demand from the Service. If the installment date has not passed, the prorated amount must be paid when the installment becomes due.

Method two—alternate extension. Under this method you may elect a 15-year period in which to pay any estate taxes attributable to the decedent's interest in a closely held business. You may not make this election if you made the election under method one.

Interest in a closely held business, for purposes of this method, is the same as under method one except that:

1) A partnership may have up to 15 partners, and
2) A corporation may have up to 15 shareholders.

In determining the number of shareholders or partners, a stock or partnership interest is treated as owned by one shareholder or partner if it is community property, or held by husband and wife as joint tenants, tenants in entirety, or tenants in common.

Property owned directly or indirectly by or for a corporation, partnership, estate, or trust is treated as owned proportionately by or for its shareholders, partners, or beneficiaries. However, with trusts, only beneficiaries with present interests are considered. A present interest means that the beneficiaries have a present right to the trust income.

The interest in a closely held farm business includes the interest in the residential buildings and other improvements occupied regularly by the owners, lessees, or employees running the farm.

Percentage requirements. To qualify for this method, the value of the closely held business must be more than 65% of the adjusted gross estate (the gross estate less expenses, indebtedness, taxes, and losses).

Each closely held business in which the decedent had more than a 20% interest is combined and treated as one business.

If you elect the special-use valuation for qualified real property for estate tax purposes, you must also use the reduced value to decide whether the 65% test is satisfied.

Time for payment. Under this method, you may elect to defer the payment of principal, but not interest, for up to 5 years from the original due date for paying the estate tax. You must pay the remaining installments annually by the date one year after the due date of the preceding installment. There can be no more than 10 installment payments.

Deficiencies. Generally, if you make the election when you file the return, the election applies both to the tax originally due and to certain deficiencies. If you do not make the election when you file the return, you may still elect to pay certain deficiencies (but not the original tax) in installments. As executor, you also may make a protective election (discussed later) under certain conditions.

Time and manner of alternate installment election. You make the alternate installment election by attaching a notice of election to a timely filed estate tax return. The notice must contain the following information:

1) The decedent's name and taxpayer identification number as they appear on the estate tax return,
2) The total amount of tax to be paid in installments,
3) The date chosen for paying the first installment,
4) The number of annual installments, including the first installment, in which the tax is to be paid,
5) The properties shown on the estate tax return that make up the closely held business interest (identified by schedule and item number), and
6) The reasons you think the estate qualifies for installment payments.

If you do not include information for items (2), (3), and (4), then the election is presumed to be for the maximum amount payable and must be made in 10 equal installments. The first payment is due 5 years after the due date for paying the estate tax.

Protective election. You may make a protective election to defer payment of any part of the tax that is still unpaid when the values are finally determined (or agreed to, following an examination of the return). This protective election also covers any deficiencies attributable to the closely held business interest. Extension of tax payments under this election depends on whether the final values meet the requirements

for method two. However, a protective election does not extend the time for paying the tax. Such an extension must be granted under another provision of the Code.

You make a protective election by filing a notice of your election with a timely filed estate tax return. Within 60 days after the values are finally determined or agreed to, you must send a letter containing a final notice of election with the required information to the Service office where you filed the estate tax return. You must pay any previously unpaid tax and interest now due, plus any unpaid tax and interest that is not attributable to a closely held business, when you file the notice of final election and that is not eligible for further extension (or currently extended) under another section of the Code.

Other rules. If you elect to pay the estate tax under method one you may not elect method two. However, if you timely elect to use either method, you may make a protective election for the other method at the same time. If you then file a timely final election notice for the method under protective election and pay any amount due currently following final determination of (or agreement as to) estate tax values, your original election for the other method will be considered to have never applied to the estate.

Example. As executor of John Blue's estate, you file the estate tax return on time. The return showed that 60% of the value of John's adjusted gross estate consisted of a farm that was a closely held business. You made a protective election for method two when you filed John's estate tax return. You also applied for an extension of time to pay $15,000 of the $30,000 of estate tax due on the return. The extension was granted and was renewed at the end of one year.

Eighteen months after the return was filed and after examination of John's estate tax return, the value of the farm was found to be 67% of the adjusted gross estate. You agreed to the values as established on examination and to a deficiency of $5,000.

You then filed a final notice of election under method two. This terminates the previous extension because that amount of tax is now included under the installment election. You could have extended payment of 67% of the total estate tax, or $23,450. This amount is eligible for installment payments and the election is considered to be for that amount. You are considered to have prepaid $3,450 of the tax since only $20,000 ($15,000 extension + $5,000 deficiency) of the tax remained unpaid. The $3,450 is attributed to the first installment of $2,345 and to $1,105 of the second installment that is payable under the election.

Had you been granted an extension of time to pay $20,000 of tax, $25,000 would remain unpaid when the final election is made. Payment of the full $23,450 (67%) of tax that is attributable to the closely held business interest is included under the election. The balance of unpaid tax ($1,550) is due when the estate's previous extension expires.

You must pay all unpaid accrued interest with your final election notice. Since only 18 months have passed, no tax installments are due. Interest on the $5,000 deficiency is computed at 4% for the entire 18 months, and interest for 12 months of that period is currently due to be paid. Interest for the remaining 6 months is due at the next date for payment of interest. Interest on the $15,000 of tax extended under the general extension is figured at the rate determined under the general extension until the date of the final election and is due upon termination of the extension. After that date, the interest on the $15,000 will also accrue at 4%. (For a discussion on interest rates see *Interest on Underpaid or Postponed Tax*, discussed later.)

Appeal procedures. The district director is responsible for determining if an election for either installment method of payment meets the specific conditions explained earlier. If the Service determines that your election meets the requirements, we will not send you a notice. You may assume that the election is acceptable, unless we tell you it is not. We will examine your election as soon as we can after it is received.

If the district director determines that your election does not meet the requirements, you may file a request for Appeals consideration. After you file the request but before a final decision is reached, you will have an opportunity for an Appeals conference. The Chief, Appeals Office, will inform you of its decision.

You may ask to have the matter referred to the National Office for technical advice if you think that a lack of uniformity exists or that the issue is so unusual or complex that it warrants consideration by the National Office. You may make this request while the case is under the jurisdiction of either the District Director or Chief, Appeals Office.

Recomputation of installments. If you have elected to pay the tax in installments, you may be able to deduct the amount of interest accruing on the installment payments as an administration expense. When the interest becomes deductible and the estate claims the deduction, the estate tax and the installments due are recomputed.

If you deduct interest after the estate tax return has been filed, you should file a supplemental Form 706 and write the words "Supplemental Information" at the top. You may file this supplement with the annual installment payment or at a later date. But you cannot file it before you pay the interest for which the deduction is claimed.

If you and the Service agree on the amounts, the unpaid tax liability and any accrued interest will be reduced. Future installments will be recalculated and any overpayments will be applied to the next installment. If the total amount of installment payments made is more than the estate tax liability, you may claim a refund by filing Form 843, *Claim*, within the period of limitations.

Installment payments will also be recomputed if, upon examination, there is a change to the estate's tax liability or to the percentage of the taxable estate that is represented by the closely held business.

After 1981. The following changes apply to an estate of a person who dies after 1981 if you elect to make installment payments of the estate tax on an interest in a closely held business.

Method. You may use a modified version of *Method two—alternate extension* to elect to pay the tax using installment payments. *Method one*, discussed earlier, does not apply to these estates. The earlier discussion on method two still applies except as indicated in the following discussion of *Percentage requirements*. Other changes relating to installment payments are also discussed.

Percentage requirements. To qualify for installment payments, the value of an interest in a closely held business must be more than ***35%*** of the adjusted gross estate.

Each closely held business in which the decedent before death had an interest of ***20% or more*** is combined and treated as one business.

Acceleration of payment. If any part of an interest in a closely held business that qualifies for installment payments is distributed, sold, exchanged, or otherwise disposed of, or if money and other property attributable to that interest is withdrawn from the trade or business, the extension of time for payment of the tax in installments will end. The unpaid part of the tax payable in installments must be paid upon notice and demand from the Service.

Disposition does not include the transfer of an interest after 1981 because of the death of the original transferee, or a later transferee, if it is transferred to a family member of the last transferor. This rule applies to all estates for which an installment method has been elected. For example, if an interest for which an election had been made was inherited by a son and that son died after 1981, the transfer to a member of that son's family is not considered a disposition.

For an estate of a person who dies after 1981, the installment method of payment will end only if the withdrawals, distributions, sales, exchanges, or other dispositions, total ***50% or more*** of the value of the interest. For the estate of a person who died before 1982, different acceleration rules applied. Under method one, discussed earlier, the installment method of payment will end only if the total withdrawals of money and other property from the trade or business equal or exceed 50% of the value of the entire trade or business. The withdrawals must be made with respect to the interest in the business that is included in the gross estate. Also, under method one, if 50% or more in value of an interest in a qualifying business is distributed, sold, exchanged, or otherwise disposed of, the installment method of payment will end. If method two—alternate extension, discussed earlier, was elected, the installment method of payment will end if one-third or more is disposed of or is withdrawn. Note, that for the estate of a person who died before 1982, the withdrawals and the dispositions are figured separately in determining the percentages.

Failure to make payments. If any payment of ***principal or interest*** is not paid by the due date of the installment (including extensions), the unpaid part of the tax payable in installments must be paid upon notice and demand from the Service. This provision does not apply for an estate of a person who dies after 1981 if the payment is made within 6 months of the due date.

However, the special 4% interest rate (discussed later) does not apply to this payment. In addition, there is a penalty of 5% a month (or fraction of a month) on the amount of the late payment.

Interest on Underpaid or Postponed Tax

As executor, you must pay interest on any amount of tax that is unpaid when the return is due, without regard to any extension of time for payment. The interest rate on these taxes is based on the prime interest rate charged by banks during September of the preceding year.

Closely held business. If you elected to make installment payments of the estate tax on an interest in a closely held business under either ***Method two—alternate extension*** or under the election that applies ***After 1981***, a special interest rate applies.

The interest rate on the estate tax that is based on the first $1 million worth of closely held business property is 4%. The maximum amount of the estate tax that may be subject to the lower 4% interest rate is the lesser of:

1) $345,800 (the estate tax on $1 million) reduced by the amount of the allowable unified credit, or
2) The amount of the estate tax that is attributable to the closely held business and that is payable in installments as discussed earlier.

If you elect installment payments and the estate tax due is more than the maximum amount to which the 4% interest rate applies, your installment payment reduces the amount of the estate tax due (to which the 4% interest rate applies). This reduction is in the same ratio that the 4% amount (item (1) or (2), described above) bears to the amount of the tax due that has been extended for the closely held business.

The regular rate of interest applies to the estate tax attributable to the value of property that exceeds $1 million.

Gross Estate

The gross estate includes the value of all property to the extent of the decedent's interest in the property at the time of death.

This section discusses the gross estate of a citizen or resident of the United States. The special rules that apply to estates of persons who are neither citizens nor residents are discussed in *Estates of Nonresident Noncitizens*.

Qualified disclaimers by beneficiaries may have effect on federal estate, gift, and generation-skipping transfers. See *Qualified Disclaimers*, in the *Gift Tax* section of this publication.

Property Owned by the Decedent

The gross estate includes property that was owned by a decedent at the time of death and was transferred at death by a will or by intestacy laws. It may also include other property interests that the decedent did not own at death. These are discussed later. The gross estate does not include property that the decedent owned at death that could not be transferred by a will or by the intestacy laws, such as a life estate created by another. (See *Certain Marital Deduction Property*, discussed later.)

The value of a remainder interest that can be ended by the act of a third party is included in the gross estate if it is not actually ended before the decedent's death. A claim for damages for pain and suffering is includible in the estate because the decedent could have recovered it before death. However, a wrongful death claim brought by the decedent's heirs generally is not included because the decedent could not have recovered it. This also applies to survivors' loss benefits paid under a no-fault automobile insurance policy. Unenforceable death benefits paid to the surviving spouse are not included in the estate.

Outstanding dividends declared to stockholders of record on or before the date of death are included in the gross estate. Those declared after the date of death are not.

Unpaid interest that has accrued on savings certificates (redeemable after death without forfeiture of interest) from the date of the last interest payment to the date of death, plus the face amount of the certificates, is includible in the gross estate.

U.S. Government bonds and other U.S. Government indebtednesses are included in the gross estate even if, by law, they are generally exempt from all federal taxes. The estate tax is a tax on the transfer of property and not a tax on the property itself. This also includes bonds issued by a state government agency and secured by a pledge of a loan by the federal government.

Income tax refund. If the estate is entitled to a refund because of an overpayment of income tax, the overpayment is an asset includible in the gross estate. If the estate and a surviving spouse are entitled to a refund because of an overpayment of income tax on a joint return, part of the overpayment is includible in the gross estate. The includible amount is the amount by which the decedent's payment of the joint income tax exceeds his or her income tax liability. The decedent's income tax liability for the period covered by the joint return is figured as follows:

1) Figure the amount of income tax for which the decedent would have been liable on a separate return (as if a separate return had been filed).
2) Figure the amount of income tax for which the spouse would have been liable on a separate return.
3) Multiply the joint tax liability by a fraction. The numerator of the fraction is the amount figured in (1). The denominator of the fraction is the total of the amounts figured in (1) and (2).

The amount arrived at in (3) is the decedent's income tax liability for the period covered by the joint return.

Medical insurance reimbursements are included in the gross estate if the decedent had a right to the amount at death.

Form 706. List real estate that the decedent owned at death on Schedule A, Form 706. List stocks and bonds on Schedule B. Enter bank accounts, promissory notes or other evidence of debt on Schedule C. List miscellaneous property, such as furniture, jewelry, personal effects, and interests in partnerships or unincorporated businesses on Schedule F.

Dower and Curtesy Interests

The gross estate includes the value of a surviving spouse's dower or curtesy interest in the decedent's estate, including a statutory interest in place of the dower or curtesy interest.

A dower interest is the part of a deceased husband's real property allowed to his widow for her lifetime. A curtesy interest is a deceased wife's real property that passes on her death to her husband for his lifetime if they have had children who are able to inherit the property.

Transfers with Retained Life Estate

The gross estate includes the value of property transferred after March 3, 1931, but before the death of the transferor, if that person kept possession or enjoyment of the property, or reserved certain rights or interests in it. This includes the right to income from the property for life (or for a period that does not in fact end before death, or that cannot be determined without reference to the decedent's death). However, if the transfer of property was made for its full worth in money (or other equal value), it is not included in the gross estate.

Rights or interests. The rights or interests that may be reserved for life include the use, possession, income, or other enjoyment of the transferred property, or the right to name persons who will possess or enjoy the transferred property or its income.

The right to designate may be exercisable alone, or, if created after June 6, 1932, with others. It does not matter if the others have adverse interests, or if they or the person that made the transfer (the transferor) act in a special position, such as a trustee or agent.

If the decedent kept or reserved one or more of these rights or interests, the amount includible in the gross estate is the value of the property transferred, minus the value of any outstanding income interest not subject to the decedent's interest or right. For its value to be excluded from the gross estate, the income interest must actually be enjoyed by someone else at the time of the decedent's death. If the decedent kept or reserved an interest or right to only a part of the transferred property, the amount includible in the gross estate is a corresponding part of the entire value of the property.

The use, possession, right to the income, or other enjoyment of the property is considered kept by or reserved to the decedent to the extent that such use, etc., is to be applied toward the discharge of a legal obligation of the decedent or otherwise for the decedent's profit. The term ***legal obligation*** includes a legal obligation to support a dependent prior to the decedent's death.

The retained life estate does not have to be legally enforceable. What matters is that a substantial economic benefit is in fact reserved. If a father transfers the title to his residence to his daughter, but at the same time privately reaches an understanding that he is to continue living there until his death, the value of the residence is included in the father's estate even though the understanding could not be legally enforced. However, if a husband transfers the title to his residence to his wife and they both continue to occupy it, no presumption of a retained life estate is present unless an agreement exists.

The following examples illustrate a reservation by the decedent for any period "that cannot be determined without reference to the decedent's death":

Example 1. A decedent reserved the right to receive the income from transferred property in quarterly payments with the condition that neither the decedent nor the decedent's estate would receive any part of the income between the last quarterly payment and the date of death.

Example 2. A decedent reserved the right to receive income from transferred property after the death of another person who, in fact, survived the decedent and who was enjoying the income from the property at the time of the decedent's death. In this case, the amount to be included in the decedent's gross estate as a

transfer with a retained life estate is the value of the entire property, minus the value of the outstanding income interest of the other person. If the other person had died before the decedent, the reservation by the decedent could be considered to be either for the decedent's life, or for a period that does not in fact end before the decedent's death.

The gross estate includes the value of property placed in trust by the decedent if the income beneficiary of the trust in turn created a comparable trust naming the decedent the income beneficiary. The trusts must have been interrelated, and the parties must have been in substantially the same position after the creation of the trusts as they would have been had they named themselves income beneficiaries of their own trusts.

Transfers to testamentary trust by a life income beneficiary. If a life income beneficiary has made lifetime contributions of property to a trust established by another person and that property remains in the trust at death, the retained interest to be included in the estate of the beneficiary is the value of that property at the time of death.

Example. Robert Blue was the life income beneficiary of a trust created by his father's will in 1974. The terms of the trust provided that the trustee had the power to receive and invest additions to the corpus and that the trust ended upon Robert's death with all assets passing to Robert's heirs.

When created, the trust corpus had a value of $10,000, and by December 21, 1976, the trust assets were worth $15,000. On that day, Robert transferred 400 shares of Maple Corporation common stock valued at $45,000 to the trust.

Robert died on May 1, 1982, when the total trust assets were worth $400,000. The total value of trust assets included the 400 shares of Maple Corporation stock with a value of $350,000.

Since the value of the 400 shares of Maple Corporation stock could be determined on the date of Robert's death, his gross estate includes, as a retained interest, $350,000. This $350,000 is the part of the trust equal to the value of the Maple Corporation stock on the date of his death.

If the trustee sold or otherwise disposed of the property contributed, and replaced it, the value of the interest the decedent had retained is that part of the trust assets the decedent contributed, figured at the time of the transfer.

Voting rights in controlled corporation stock. If a decedent transferred stock of a ***controlled corporation*** after June 22, 1976, and kept the right to vote in the shares (either directly or indirectly), the retention of the voting rights is a retention of the enjoyment of transferred property. The value of the transferred stock is included in the gross estate. This does not apply to the transfer of stock in a controlled corporation if the person could not vote the transferred stock.

Voting rights are indirectly retained if there is an agreement or arrangement with a trustee to vote the stock according to the transferor's directions. Voting rights may be indirectly retained under an oral agreement with the trustee even if there is no such agreement in the trust instrument.

Controlled corporation. A corporation is a controlled corporation if at any time after the transfer of property and during the 3-year period ending on the date of death, the decedent—

1) Directly or indirectly owned or
2) Had the right, either alone or with another person, to vote

stock having at least 20% of the total combined voting power of all classes of stock.

In determining whether the corporation is a controlled corporation, the decedent is considered to own stock under the following rules.

1) ***Members of the family.*** A decedent is considered as having owned the stock held directly or indirectly by or for:
   a) A spouse (other than one legally separated from the person under a decree of divorce or separate maintenance), or
   b) A child, grandchild, or parent. A legally adopted child is treated the same as a natural one.
2) ***Partnerships and estates.*** Stock owned, directly or indirectly, by or for a partnership or estate is considered as having been owned by its partners or beneficiaries in proportion to their interest in the partnership or the estate.
3) ***Trusts.*** Stock owned, directly or indirectly, by or for a trust is considered as having been owned by the beneficiaries in proportion to their actuarial interest. (Stock owned by a tax-exempt qualified employee benefit plan trust is not included.) Stock owned, directly or indirectly, by or for any part of a trust of which a person was considered the owner or substantial owner is considered as having been owned by that person.
4) ***Corporations.*** If 50% or more in value of corporation stock was owned, directly or indirectly, by or for any person, that person is considered as having been the owner of any stock held (either directly or indirectly) by or for the corporation in the proportion that the value of the stock the person owned bears to the value of all the stock in the corporation.
5) ***Options.*** If the decedent had an option to acquire stock, the stock is considered as having been owned by the decedent. An option to acquire that option and each one of a series of those options is considered an option to acquire the stock.

Form 706. These transfers are included on Schedule G, Form 706.

Transfers Taking Effect at Death

The gross estate includes the value of property interests transferred by the decedent after September 7, 1916, if all the following conditions exist:

1) The beneficiaries could have possessed or enjoyed the transferred property through ownership of it, only by surviving the decedent,
2) The decedent kept a reversionary interest in the property, and
3) The value of the reversionary interest immediately before death was more than 5% of the value of the entire property.

However, the gross estate does not include the value of a transferred interest if the transfer was made for its full worth in money or something else of equal value.

First condition. The first condition is met if the only way any beneficiary can get possession or enjoyment of the property through ownership of it is by surviving the decedent.

Example 1. Paul Birch transferred property in trust with the income payable to his wife for life. At her death, the remainder interest passes to their surviving child, or if there is no surviving child, to Paul or his estate. Since each beneficiary can possess or enjoy the property without surviving Paul, no part of the property is includible in his gross estate when he dies as a transfer taking effect at death, regardless of the value of his reversionary interest.

Example 2. The first condition would be met if Paul transferred property in trust with the income payable to his wife for her life with the remainder payable to him or, if he is not living at his wife's death, to their child or their child's estate. The child cannot obtain possession or enjoyment of the property without surviving the father. Therefore, if Paul's reversionary interest immediately before his death was more than 5% of the value of the property, the value of the property, minus the value of the wife's outstanding life estate, is includible in his gross estate.

Second condition. The second condition is met if the decedent kept a reversionary interest in the property transferred. ***Reversionary interest*** includes a possibility that the transferred property may return to the decedent or to the decedent's estate and a possibility that the property may become subject to a power of disposition by the decedent. The term generally refers to any right under which the transferred property will or may be returned to the grantor. It does not matter if the right arises by the express terms of the instrument of transfer or by operation of law. However, if the transfer was made before October 8, 1949, and if the right to the return of the property does not arise because of the express terms of the instrument of transfer, the value of the property transferred is not includible in the gross estate as a transfer taking effect at death, regardless of the value of the reversionary interest.

The possibility of receiving income only from the transferred property after the death of another person is not a reversionary interest within the meaning of that term. The term ***reversionary interest*** does not include the possibility that the decedent during his or her lifetime might have gotten back an interest in the transferred property by inheritance through the estate of another person.

Example. Kevin Spruce transferred property in trust with the income payable to his wife for life and the remainder payable to himself or, if he was not living at his wife's death, to their child or the child's estate. By the terms of the trust, Kevin kept a reversionary interest because he kept the right to have the property returned to him if he survived his wife. He had this right up to the moment preceding death.

Third condition. The third condition for includibility is met if the value of the reversionary interest, as of the moment preceding death, is more than 5% of the value of the property transferred. See *Annuities, Life Estates, Terms for Years, Remainders, and Reversions,* for the method of determining the value of a reversionary interest.

Death benefit under employment contract. An employment contract may provide that the em-

ployer will pay a death benefit during the term of the contract to the employee's spouse or to the employee's estate if the spouse dies first. This is a transfer that takes effect at death. The employee retained a reversionary interest in the death benefit. If the value of the reversionary interest in the death benefit at the moment before death was more than 5% of the payment, the value of the death benefit is included in the employee's gross estate.

Example. John Elm entered into an employment contract with Maple Corporation. The employment contract provides that Maple Corporation will pay a stated death benefit to John's wife if John is an employee of the corporation at his death. If John's wife dies before him, the contract allows the benefit to be paid to his estate.

After John's death, the death benefit was paid to his wife under the terms of the contract. The value of John's reversionary interest in the death benefit payment was more than 5% of the value of the payment at the moment before death.

Because the interest meets all three conditions described in this section, the value of the death benefit is includible in John's estate as a transfer taking effect at death.

Form 706. These kinds of transfers are listed on Schedule G, Form 706.

Revocable Transfers

The gross estate includes the value of property interests transferred by a decedent that were subject to an exercisable power of the decedent. (This does not apply to the extent the transfer was made for its full worth in money or something of equal value.) If the enjoyment of the interest transferred was subject to any power of the decedent to change or end the transfer on the date of death, the value of that property interest is included in the gross estate. The same result occurs if the power was given up by the decedent within 3 years of the date of death. A decedent's power to change the beneficiaries or to hasten or increase any beneficiary's enjoyment of the property are examples of this. The decedent, either alone or with others, must have held this power at the time of death or within 3 years of the date of death. However, if the use of the power was limited by a condition beyond the decedent's control, and that condition did not occur before death, the property is not included in the gross estate as a revocable transfer.

Use of the power. The capacity in which a decedent could use the power has no bearing. If the decedent gave property in trust and was the trustee with the power to revoke the trust, the property would be included in his or her gross estate. If the decedent named another person trustee but kept the power to later appoint himself or herself trustee with power to revoke, the property also would be included in the gross estate. (A similar result occurs if the decedent reserved the power to remove the trustee at will and appoint another trustee of an irrevocable trust for any transfer or addition to the trust after October 28, 1979.) If, however, the power to change or end was held at all times solely by a person other than the decedent and the decedent reserved ***no*** right to assume these powers, the gross estate does not include the value of this property.

Property interests generally are included in the gross estate even though the power to change or end them could be used by the decedent only along with others, regardless of their capacity or interests. There are ***two exceptions.***

First, if the transfer was made before June 2, 1924, and the power can be used only with a person having a substantial adverse interest, the value included in the gross estate will not include the value of that other person's interest.

Second, property is not included in the gross estate regardless of when it was transferred, if the decedent's power could be used only with the consent of all parties having an interest in the property, and if the power added nothing to the rights of the parties under local law.

The power may arise from the express provision of the transfer, by operation of law, or by an unrelated action at a later date. It is not necessary that the decedent kept the power on the date of the transfer (except for transfers occurring before June 23, 1936) as long as the decedent had the power at the date of death or within 3 years before death.

Only the part of the transferred property that is subject to the decedent's power, as described above, is included in the gross estate.

Form 706. Revocable transfers are listed on Schedule G, Form 706.

Annuities

The gross estate includes the value of an annuity or other payment that a beneficiary is due to receive because he or she survives the decedent. This pertains to certain contracts or agreements entered into after March 3, 1931, (other than life insurance). The value included is based on contributions made by the decedent or the decedent's employer.

A pure annuity contract that provides periodic payments to a person for life and ceases at the person's death is not included in the gross estate. Only certain annuities that continue to provide payments to surviving beneficiaries after the decedent dies are included in the gross estate. The inclusion of the proceeds of a life insurance contract on the decedent's life is determined under special rules discussed later in *Proceeds of Life Insurance.*

Annuity or other payment. The term annuity or other payment refers to one or more payments extending over any period of time. The payments do not have to be made in equal amounts or at regular intervals.

Contracts or agreements include any arrangement, understanding, or plan that is due to the decedent's employment.

A surviving spouse may be eligible to receive social security benefits if the decedent had been subject to the taxes imposed by the Federal Insurance Contributions Act or the Self-Employment Contributions Act. These benefits are not paid because of an employment contract or agreement. Therefore, the value of monthly benefits payable to a surviving spouse under the ***Social Security Act*** is not includible in the decedent's gross estate as an annuity or other payment, or as property in which the decedent had an interest at the time of death. This rule also applies to monthly payments receivable by the surviving beneficiaries under the Railroad Retirement Act.

Death benefits payable under the ***Public Safety Officer's Benefit Act***, which provides for the payment of benefits to survivors of local, state, and federal public safety officers who died in the performance of duty, are not includible in the gross estates of such decedents because they are not paid under any form of employment contract or agreement.

Conditions. The annuity or other payment receivable by any beneficiary is included in the gross estate if ***either*** of the following conditions is met.

1) The annuity or other payment was payable to the decedent, either alone or in conjunction with another person or persons,
   a) For the decedent's life, or
   b) For any period that can be determined only with reference to the decedent's death (see *Transfers with Retained Life Estate*), or
   c) For any period that does not in fact end before the decedent's death; or
2) The decedent must have possessed, for any period described in (1) the right to receive such an annuity or other payment, either alone or with another person or persons.

An annuity or other payment that is not includible in the gross estate as an annuity may still be includible under some other applicable provision of law. For example, survivor annuity payments that remain payable at a survivor's death, under a qualified noncontributory plan, are includible in the survivor's gross estate if the survivor had the unrestricted power to select the beneficiary of the remaining payments. See *Powers of Appointment*, discussed later.

An annuity or other payment ***was payable*** to a decedent if, at the time of death, the decedent was in fact receiving an annuity or other payment, with or without an enforceable right to have the payments continued. The decedent had the ***right to receive*** an annuity or other payment if, immediately before death, the decedent had an enforceable right to receive payments at some time in the future, whether or not, at the time of death, the decedent had a present right to receive payments.

Amount included in gross estate. If the decedent contributed only part of the purchase price of the contract or agreement, the gross estate includes only that part of the value of the annuity or other payment receivable by the surviving beneficiary that the decedent's contribution to the purchase price bears to the total purchase price. Contributions made by the decedent's employer (or former employer) to the purchase price of the contract or agreement are considered made by the decedent if the contributions are made because of the decedent's employment. However, if the payments are made under a qualified plan, the employer's contributions are not taken into consideration. (See *Exemption of Certain Annuities.*)

Example. Assume at death the value of an annuity payable to a beneficiary is $20,000. Before death, the decedent was receiving payments under the annuity contract. The annuity contract cost $25,000, of which the decedent had paid $15,000. The remaining cost was paid by the decedent's spouse. The value included in the decedent's gross estate is $12,000 ($15,000 ÷ $25,000 × $20,000 = $12,000). If the annuity was part of a nonqualifying retirement plan and the decedent's employer rather than the spouse had paid the remaining cost, $20,000 ($25,000 ÷ $25,000 × $20,000 = $20,000) would be included in the decedent's gross estate.

Exemption of Certain Annuities

All or a part of the value of an annuity or other payment receivable by any beneficiary other than the executor may be excludable from the decedent's gross estate if the payment is made under:

1) An employees' trust forming part of a ***qualified*** pension, stock bonus, or profit-sharing plan,
2) An annuity contract purchased by an employer under a ***qualified*** annuity plan,
3) An annuity contract purchased for an employee by certain tax-exempt organizations or public schools,
4) The Retired Serviceman's Family Protection Plan or Survivor Benefit Plan,
5) A bond purchase plan, or
6) An individual retirement arrangement (IRA).

However, lump-sum distributions under ***qualified*** plans are excludable only if the recipient elects not to treat any part of the distribution as taxable under the 10-year averaging method or as long-term capital gain. The election is made on the recipient's income tax return and cannot be changed.

No exclusion is allowable to the extent that the amounts payable after death are based on payments or contributions made by the decedent. A deductible voluntary employee payment is not treated as a contribution made by the decedent. A deductible voluntary employee payment is a payment made after 1981 to a qualified retirement plan for which an income tax deduction was allowable.

If only a beneficiary other than the executor of the estate can receive the annuity and ***if the decedent made no contributions to its cost under the plan***, no part of the annuity's value is includible in the gross estate. In order for these provisions to apply, however, the decedent must be the employee who accrued the benefits under the plan rather than merely a beneficiary who was entitled to benefits. If the decedent contributed to the plan, the gross estate includes that part of the value of the annuity that is proportionate to the total payments made by the decedent compared to the total payments made.

Contributions to the plan. In determining whether contributions to a plan (described in (1) through (5) above) are made by the employer or the employee, the following rules apply.

1) Employees' trust.
   a) Contributions made under a plan for a person while that person was self-employed are considered made by the employer to the extent the contributions are deductible for income tax purposes. If the contributions are not deductible, they are considered made by the employee.
   b) A rollover contribution is considered made by the employer.
   c) An amount includible in the gross income of a shareholder-employee of a Subchapter S corporation, because contributions that are deductible by the corporation exceed certain amounts, is considered made by the employee.
2) Annuity contract purchased by employer. The provisions described in (1) apply to qualified annuity plans purchased by the employer.
3) Certain tax-exempt organizations.
   a) Contributions made by certain tax-exempt organizations or public schools to purchase an annuity contract are considered made by the employer to the extent the contributions were excludable from the employee's gross income. Any contributions includible in the employee's gross income are considered contributions made by the employee.
   b) A rollover contribution is considered made by the employer.
4) Retired Serviceman's Family Protection Plan. Amounts deposited by a person to the Retired Serviceman's Family Plan or Survivor Benefit Plan are considered that person's contribution to the plan. These deposits are amounts required to be paid into the plan by a person after retirement for a period when he or she is not receiving retirement or retainer pay. The amount of the deduction in a retiree's annuity under an election to provide a survivor annuity is not considered a deposit to the plan.
5) Bond purchase plan. The provisions described in (1)(a) and (c) apply to a bond purchase plan.

Amount included in gross estate. For qualified plans to which the employee made contributions, the gross estate includes a share of the value at the decedent's death of the annuity or other payment receivable by the beneficiary. To figure the includible amount, multiply this value by the employee's contribution. Then divide this amount by the total contributions that were made either on the employee's account to the plan, or towards the purchase of the annuity contract.

In certain cases, the employer's contribution to a plan on the employee's account, and therefore, the total contributions to the plan on the employee's account, cannot be readily determined. To figure the amount to be included in these cases, use the method that follows unless you can present a more precise method. In these cases, the total contributions to the plan on the employee's account is the value of any annuity or other payment payable to the decedent and the decedent's survivor figured as of the time the decedent's rights first mature. (It is figured as of the time the survivor's rights first mature if the decedent's rights never mature.)

Example. Under a qualified pension plan, the employer and the employee contributed to a trust that was to provide the employee, on his retirement at age 60, with an annuity for life. The plan also was to provide the employee's spouse, upon the employee's death after retirement, with a similar annuity for life. The employer did not credit its contributions to the fund to the accounts of individual employees.

The amount included in the estate of the decedent was $4,000 determined as follows:

1) Value of the employee's annuity and the annuity of the spouse computed at the time of retirement	$40,000
2) Employee's contribution to the plan (including accrued interest)	$10,000
3) Value at the decedent's death of the spouse's annuity	$16,000
4) Amount includible:	
$\frac{\$10,000}{\$40,000} \times \$16,000 =$	$ 4,000

Employee contributions previously refunded at retirement. If a person contributes to a qualified pension plan with separately maintained and segregated accounts for employee and employee contributions and elects, at retirement, to receive a lump-sum refund of employee contributions with accrued interest, any survivor annuity payable to the spouse of that person is solely attributable to employer contributions. Thus, the survivor annuity is excludable from the gross estate.

Example. Paul Black was employed by State X until his retirement in 1979. Before retirement Paul was a participant in the State X employee pension plan, which was a qualified plan.

Under the plan, State X contributed to the plan a stated percentage of the total compensation paid to participants. A participant could contribute a percentage of annual compensation to the plan. The contributions of a participant and State X are deposited in the same trust fund; however, the participant's contributions and the additions to it are always maintained in a separate account and can always be precisely determined. The contributions made by State X also are maintained in a separate account.

Under the plan, retiring employees may choose how they want to receive retirement benefits. One option permits an employee to receive a refund of all employee contributions (with accrued interest) along with a pension to the retiree and an annuity to the employee's surviving spouse. Since the amount payable under this option is based only on employer contributions, the amounts of pension and survivor annuity payable are less than under other available options.

Upon retirement, Paul elected to receive benefits under the above option. He received a lump sum consisting of his contributions (with interest) and a pension during his life. Paul died in 1982, and his wife was eligible to receive an annuity for her life.

The survivor annuity payable to Paul's wife is excludable from Paul's gross estate since the survivor annuity is based solely on the separately maintained contributions of the employer.

Annuity interests created by community property laws. Only one-half of the value of the survivor benefits are includible in the decedent's gross estate when the decedent made the contributions to a qualified plan from community funds.

In most community property states, a taxpayer's spouse is considered to have an interest in the earnings and accumulated benefits of the taxpayer.

If an employee's spouse dies first, the spouse's community interest in the employee's accumulated benefits is excluded from the spouse's gross estate under certain conditions. This applies if the contributions were made to a qualified trust by an employer or former employer, or if payments made to buy a qualified annuity for the employee are not considered as contributed by the employee.

The community interest that is excluded is

1) The interest of the deceased spouse that was based on employer contributions or payments; and
2) The interest that arose only because of the decedent's interest in community income under a state's community property laws.

The value of the deceased spouse's community property interests ***attributable to contribu-***

tions made by the employee spouse are includible in the deceased spouse's gross estate.

Civil service retirement benefits. For estate tax purposes, state community property laws do not apply to annuities, death benefits, or refunds payable under the Civil Service Retirement Act. Therefore, the value of the retirement benefits includible in the gross estate is not reduced because of the community property laws.

If the spouse of a civil service retiree dies before the retiree, the deceased spouse has no community interest in the retiree's civil service retirement benefit. Therefore, no part of the civil service retirement benefits is includible in the gross estate of the decedent spouse.

Individual retirement arrangements (IRA's). An individual retirement account, an individual retirement annuity, and a retirement bond are IRA's. Generally, the gross estate does not include the value of a qualifying annuity receivable by a beneficiary (other than the executor) under an IRA.

The exclusion applies only to the gross estate of a decedent on whose behalf the IRA was established. It does not apply to the gross estate of a decedent who was only a beneficiary under the IRA.

A ***qualifying annuity*** means an annuity contract or other arrangement that provides a series of substantially equal periodic payments to a beneficiary for life or over a period ending 36 months or more after the decedent's death. ***Periodic*** means that payments are made to the beneficiary at regular intervals. Optional payment provisions are considered to provide periodic payments only if an option providing periodic payments is elected by the earlier of the date the estate tax return is actually filed, or the date the estate tax return is due (including extensions). The right to surrender a contract for a cash surrender value is not considered an optional payment provision.

Payments are ***substantially equal*** even if the amounts receivable by the beneficiary may vary. However, the payments are not considered substantially equal if more than 40% of the total amount payable to the beneficiary under the IRA, figured at the date of the decedent's death and excluding any after-death increases, is payable in any 12-month period.

Exclusion. Generally, the entire value of a qualifying annuity payable under an IRA is excluded from the decedent's gross estate. However, the exclusion does not apply to the part of the value of the annuity attributable to the part of the total payments (minus certain withdrawals) that is from payments for which an income tax deduction was not allowed and certain rollover payments.

Payments for which an income tax deduction are not allowed are those in excess of the annual limit on deductible payments. If these excess payments are in the IRA on the date of death, part or all of the annuity is included in the gross estate.

The gross estate includes part or all of an annuity from an IRA if certain rollover payments are included in the IRA. However, qualifying rollovers from an employees' trust, a qualified annuity plan purchased by an employer, an annuity contract purchased by certain tax-exempt organizations or public schools, a bond purchase plan (if the bonds were redeemed after August 13, 1981), or any IRA are not taken into account for this purpose.

Form 706. Annuity interests are listed on Schedule I, Form 706.

Joint Interests

The gross estate includes the value of property held jointly at the time of death by the decedent and anyone who has the right of survivorship. However, that part of the property that was acquired by a person other than the decedent for adequate and full consideration in money or money's worth, or by bequest or gift from a third party is not included in the decedent's gross estate. As the executor of the estate, you must prove that the other person (joint owner) acquired his or her interest for consideration or by bequest or gift. Consideration given by a surviving joint owner does not include money or property that was acquired from the decedent for less than a full and adequate consideration in money or money's worth. This general rule applies to all joint interests unless the interests are ***qualified joint interests***, discussed later.

A special rule (discussed later) allows estates of individuals who died after 1978 and before 1982 to exclude part of the value of jointly owned property used in a farm or other business.

If property held in joint tenancy by a husband and wife is purchased with community property funds in which each had vested equal interests, each is considered to have contributed half of the consideration for the jointly held property. Only one-half of the value of the property is included in the gross estate of the decedent.

If the owners of property in joint tenancy were jointly and severally liable on a mortgage on that property, and, if, at the death of a joint tenant, the mortgage is outstanding, the surviving joint tenant's total contribution to the purchase is the sum of that survivor's actual payments for the purchase, later mortgage payments, and one-half of the mortgage indebtedness that remained outstanding at death.

If a second mortgage is taken out on property owned by joint tenants, or if a mortgage is refinanced, the surviving joint tenant's contribution based on these mortgages depends on how the mortgage funds are used. The survivor's contribution will include one-half of the unpaid balance on these mortgages if the funds were used to make capital improvements to the property or to pay off the original mortgage and make capital improvements. However, a second mortgage, or that part of a refinanced mortgage, that is used for other purposes will not be included as part of the survivor's contribution.

Uniform Simultaneous Death Act. Certain states have adopted the Uniform Simultaneous Death Act to provide for the devolution of property when individuals die at the same time.

The Act provides that for property held jointly by the decedents, one-half of the property is to be distributed as if one person had survived the other and one-half as if the other had survived. Therefore, one-half of the value of the property is includible in the gross estate of each decedent. However, if one decedent had contributed the entire consideration for the property held jointly, the full value of the property is included in that decedent's estate and one-half of the value of the property is included in the other decedent's estate.

If spouses are joint tenants or tenants by the entirety, the marital deduction is available for the one-half of the property that is included in each spouse's estate. See *Marital Deduction*, for more information about determining that deduction.

Qualified joint interests. The gross estate includes one-half of the value of a qualified joint interest at the date of death or on the alternate valuation date, no matter how much each spouse provided toward the purchase price.

A qualified joint interest for the estate of an individual who died before 1982 is an interest created after 1976 held by a decedent and the decedent's spouse as joint tenants or tenants by the entirety. However, the interest must have been:

1) Created by the decedent, the decedent's spouse, or both, and
2) A completed gift, if the interest is in personal property, or
3) Treated as a taxable gift when the joint interest was created, if the interest is in real property.

In a joint tenancy only the decedent and the decedent's spouse may be joint tenants.

A qualified joint interest does not include a joint tenancy inherited by both spouses, because it is not created by one or both of them, or a joint bank account if the donor keeps the right to withdraw all funds, because a gift must be a completed gift.

Election to have a pre-1977 joint tenancy treated as a qualified joint interest. Before 1980, a donor could elect to treat a joint interest in property created before 1977 as a ***qualified joint interest*** without going through the formal steps of severing the joint interest and re-creating a qualified joint interest. After 1979, a donor must go through these formal steps in order to obtain treatment as a qualified joint interest. The pre-1977 joint interest must have met only requirements (1) and (2) discussed earlier for a qualified joint interest that is created after 1976.

A substantial improvement of any property is treated as the creation of a separate joint interest for joint interests created before 1977 that are electing to be treated as a qualified joint interest.

Treatment of post-1976 terminations. If a pre-1977 joint tenancy was severed and re-created after 1976, the donor may elect to have the re-created joint tenancy treated as a qualified joint interest under the following conditions:

1) Before January 1, 1977, a husband and wife had a joint interest in property with right of survivorship,
2) After December 31, 1976, the joint interest is terminated, and
3) After December 31, 1976, a joint interest of the husband and wife was created in that property (or in other property whose basis wholly or partly reflects the basis of the property in (1)).

Treatment as a qualified joint interest was available after 1979 and before 1982, only if you sever and re-create the interest and file a gift tax return for the quarter in which the re-creation occurs.

Jointly held property used in a farm. An election for jointly held property used as a farm or for farming purposes or for any other trade or business is available for the estate of a person who dies after 1978 and before 1982. This election reduces the value of an ***eligible joint inter-***

est includible in the gross estate, by the following:

1) The excess of the value of the eligible joint interest at the date of death over the total adjusted consideration furnished by the decedent and the decedent's spouse, ***multiplied by*** 2% for each tax year (up to 50%) in which the surviving spouse materially participated in the operation of the farm or other trade or business; plus
2) Any adjusted consideration furnished by the decedent's spouse.

This reduced value treatment is available only if the estate timely elects to have it apply to that interest. The election must be made no later than the time for filing the estate tax return (including extensions).

The value that is reduced is the fair market value of the property even though the special valuation method for farms or other closely held businesses is elected by the estate. The special valuation method may be used for that part of the property that is included in the estate after the reduction.

Limitations. If this election is made, at least 50% of the value of the eligible joint interest must be included in the gross estate. The overall reduction in the value of the gross estate because of this election is limited to $500,000. In addition, the election does not apply if the adjusted consideration provided by both spouses equals or exceeds the value of the property at the individual's death.

Material participation means participation like that which would make a person liable for self-employment tax.

Eligible joint interest is any interest in property held by the decedent and the decedent's spouse as joint tenants or as tenants by the entirety, but only if:

1) The joint interest was created by the decedent, the decedent's spouse, or both, and
2) In a joint tenancy, only the decedent and the decedent's spouse are joint tenants.

Adjusted consideration, as used here, means the sum of:

1) The consideration furnished by the individual concerned, as determined under the rules for joint interest property described earlier, but not including any income or gain from the business that includes such property, and
2) An amount equal to that interest that the consideration, described in (1), would have earned over the period in which it was invested in the farm or other business, if it had been earning interest throughout such period at 6% simple interest.

After 1981. The term ***qualified joint interest***, for an estate of a person dying after 1981, means any interest in property held by the decedent and the decedent's spouse as:

1) Tenants by the entirety, or
2) Joint tenants with right of survivorship, but only if the spouses are the only joint tenants.

If the interest in property is a qualified joint interest, one-half of the value will be included in the gross estate of the spouse who dies first. This rule applies even if the surviving spouse furnished the total consideration for the property.

The rules for the election for pre-1977 joint tenancy, treatment of post-1976 terminations, and jointly held property used in a farm do not apply to the estate of a person dying after 1981.

Form 706. Jointly owned property is listed on Schedule E, Form 706. Real property that the decedent held as a tenant in common is listed on Schedule A, Form 706.

Powers of Appointment

The gross estate includes the value of property interests over which the decedent had a ***general power of appointment*** at death. The existence of the power does not depend on the capacity of the decedent to exercise the power. Included is the value of property interests over which the decedent exercised or released the power during lifetime if the exercise or release was:

1) Within 3 years of death (as described in *Transactions Within 3 Years of Death*), or
2) With a retained life interest in the property appointed (as described in *Transfers with Retained Life Estate*), or
3) With a retained reversionary interest in the property appointed (as described in *Transfers Taking Effect at Death*), or
4) With a retained power to alter, amend, revoke, or terminate the appointment (as described in *Revocable Transfers*).

There are different rules for including property subject to a general power of appointment if the power was created before October 22, 1942. These are discussed later.

Power of appointment. A power of appointment determines who will own or enjoy the property subject to the power and when they will own or enjoy it. The power must be created by someone other than the decedent. It does not include a power created or held on property transferred by the decedent. It does not matter whether a power is actually called a power of appointment in a legal document. It also does not matter if the term is used in local property law. What matters is that the power exists in substance and effect.

Example. If the property laws of a state give the wife a power of testamentary disposition over property to which she does not have a vested title, she is considered to have a power of appointment for federal estate tax purposes.

Some powers do not in themselves constitute a power of appointment. For example, a power to amend only administrative provisions of a trust that cannot substantially affect the beneficial enjoyment of the trust property or income would not be considered a power of appointment. A power to manage, invest, or control assets, or to allocate receipts and disbursements, when exercised only in a fiduciary capacity, would also not be considered a power of appointment.

General power of appointment. A general power of appointment is one in which decedents could have appointed the property subject to the power to themselves, their creditors, their estates, or the creditors of their estates. It includes the unlimited power to use income or corpus or both for the decedent's benefit. Thus, if a decedent received the power to appoint the corpus of a trust to any of six persons not including the decedent, but also received the power to invade corpus for any reason for the decedent's own benefit, the decedent would have a general power of appointment. However, a power of the decedent to consume or invade for the decedent's own benefit, ***limited by an ascertainable standard*** relating to health, education, support or maintenance, is ***not*** considered a general power of appointment. A power to use property for the ***comfort, welfare, or happiness*** of the decedent is ***not*** an ascertainable standard and therefore is a general power of appointment.

Example. Michael Elm, the decedent, was given the power to appoint the corpus of a trust. He could appoint any of six persons not including himself, and he could also invade the corpus for his own reasonable support, education, and medical expenses. He would not be considered to have a general power of appointment.

A power of appointment is not a general power if, by its terms, it is either exercisable only in favor of one or more designated persons other than the decedent, the decedent's creditors, the decedent's estate, or creditors of the decedent's estate, or is expressly not exercisable in favor of the decedent, the decedent's creditors, the decedent's estate, or the creditors of the decedent's estate.

Joint powers. The decedent is not considered to have had a general power of appointment if the power could be used only with the consent or together with the creator of the power, or a person having a substantial adverse interest in the property subject to the power. A trustee administering a trust as a fiduciary does not have an adverse interest in the trust.

Right under the Uniform Gifts to Minors Act. If under the Uniform Gift to Minors Act the decedent-parent has a right to petition a court to order the custodian of property, transferred under the Act by a person other than the decedent, to apply the property for the child's benefit, the right to petition the court does not constitute a general power of appointment. The value of the custodial property is not includible in the decedent-parent's gross estate.

Exercised or released. Property interests subject to a general power of appointment are includible in the gross estate if a decedent held that power at death. They are also includible if the decedent had previously exercised or released the power in such a way that, if it had been a transfer of the decedent's own property, it would have been included in the gross estate as a transfer within 3 years of death, a transfer with a retained life estate, a transfer taking effect at death, or a revocable transfer.

Example. If the decedent had been given a general power of appointment over a farm and had exercised the power in favor of his son but had also retained the use of the farm himself for life, the value of the farm would be included in his gross estate.

Property subject to the power is not included in a gross estate if the decedent released the power completely (and not within 3 years of death) and if the decedent held no interest in or control over the property. If the failure to exercise a general power of appointment results in a ***lapse*** of the power, the lapse is treated as a release only to the extent that the value of the property that could have been appointed by the exercise of the lapsed power is more than the greater of either $5,000 or 5% of the total value, at the time of the lapse, of the assets, or proceeds, out of which the exercise of the lapsed power could have been satisfied.

In contrast to a release, if a decedent had disclaimed or renounced a general power of appointment, the property is not included in the

gross estate. A disclaimer is a complete and unqualified ***refusal to accept*** the power of appointment. There can be no disclaimer of a power after it has once been accepted, and the disclaimer must be a qualified disclaimer, as discussed in the *Gift Tax* section of this publication.

The surviving spouse's nonexercise of the right to take a statutory share in place of the share provided in the decedent spouse's will is a complete disclaimer of that right by operation of law.

General powers of appointment created before October 22, 1942. Property subject to a general power of appointment created before October 22, 1942, is included in the gross estate only if exercised. The power must be exercised by the decedent either by will, or by a transfer that is of such a nature that if the property had been the decedent's property, it would be included in the decedent's gross estate as just explained under *Exercised or released.*

Property subject to such a power is not included in the gross estate if the decedent released the power either during life or at death, or allowed the power to lapse. Also, a power created before October 22, 1942, and given to the decedent but exercisable only in conjunction with another person, regardless of adverse interest, is not treated as a general power of appointment.

Creation of power. A power of appointment created by will is generally considered created on the date of the creator's death. However, a power of appointment created by a will executed before October 22, 1942, is considered as created before that date if the creator died before July 1, 1949, without having republished the will after October 21, 1942. A power of appointment created by an inter vivos instrument is considered as created on the date the instrument takes effect. Such a power is not considered as created at some future date merely because it is not exercisable immediately, because it is revocable, or because the identity of its holders cannot be determined until after the date the instrument takes effect. However, if the holder of a power exercises it by creating a second power, the second power is considered as created at the time of the exercise of the first.

Form 706. Property subject to a general power of appointment that is includible in the gross estate is listed on Schedule H, Form 706.

Proceeds of Life Insurance

The gross estate includes the proceeds of life insurance ***on the decedent's life*** if:

1) The proceeds are receivable by the estate, or
2) The proceeds are receivable by another for the benefit of the estate, or
3) The proceeds are not receivable by or for the benefit of the estate and the decedent possessed ***incidents of ownership*** in the policy.

Life insurance ***on the life of another,*** owned by the decedent at the decedent's death, is included in the gross estate as ***property owned at death,*** as discussed earlier in *Property Owned by the Decedent.* In this case the amount includible is the replacement value of the policy. When the replacement value cannot be readily determined, the value of the policy may be approximated by adding the interpolated terminal reserve at the date of death and a proportionate share of the last premium paid.

The term ***life insurance*** means all kinds of life insurance including:

1) Whole life policies,
2) Term insurance,
3) Group life insurance,
4) Double indemnity, travel, and accident insurance,
5) Endowment contracts (before being paid up), and
6) Death benefits paid by fraternal beneficial societies operating under the lodge system.

The term life insurance, however, does not include:

1) Refunds of premiums in case of suicide, and
2) No-risk, single-premium policies combining annuities and life insurance.

Receivable by or for estate. The gross estate includes proceeds of insurance on the life of the decedent receivable by the executor or payable to the decedent's estate. The estate does not have to be specifically named as the beneficiary.

If the proceeds of a policy are receivable by an individual beneficiary and these proceeds are subject to a legal obligation on the beneficiary to pay taxes, debts, or other charges enforceable against the estate, the proceeds required for payment of these obligations are includible in the decedent's gross estate to the extent of the beneficiary's obligation.

Incidents of ownership. Proceeds of insurance on the life of a decedent, not receivable by or for the benefit of the estate, are includible if the decedent held, at death, any of the incidents of ownership in the policy, exercisable either alone or together with any other person. This applies even if the decedent was acting as a trustee. In this context, the term ***incidents of ownership*** does not mean only the ownership of the policy in a technical, legal sense. Here, the term refers to the right of the insured or the insured's estate to the economic benefits of the policy. It includes the power to change beneficiaries, to revoke an assignment, to obtain a loan against the surrender value, to pledge the policy for a loan, or to surrender or cancel the policy. Rights that are not considered to be incidents of ownership include the right to receive dividends and the right to veto the sale by a trustee of an irrevocable funded insurance trust.

Example. In 1970 the decedent, Bob Gray, purchased an insurance policy on his life and named his wife as beneficiary. In 1974 Bob transferred complete ownership of the policy to his wife and also named their children as beneficiaries. In 1977 his wife died and in his wife's will, Bob was named executor of his wife's estate and the trustee of a residuary trust established for the children. The insurance policy on Bob's life was included in his wife's residuary estate.

As trustee, Bob was granted absolute discretion to distribute the current income to the beneficiaries or accumulate the income and add it to the corpus. Bob also was empowered in the management and investment of the trust property to do anything with the property as if it were his own. Under the terms of the policy, the owner could elect to have the proceeds made payable according to various plans, use the loan value to pay the premiums, borrow on the policy, assign or pledge the policy, and elect to receive the annual dividends.

Bob died in 1981, and the proceeds of the policy were included in his gross estate since he possessed an incident of ownership in the policy. Although he held the policy in a fiduciary capacity, his control was an incident of ownership, since he, as trustee, had the right to elect optional modes of settlement and borrow on the policy under the terms of the trust and insurance. Simply, he had a substantial degree of control over the time and the enjoyment of the policy proceeds.

The gross estate includes group life insurance policy taken out by an employer on the decedent's life if the decedent owned the right to change the beneficiaries, the right to terminate the policy, or the right to prevent cancellation by purchasing the policy. In addition, a decedent's right to select a settlement option for the proceeds is generally an incident of ownership.

The power to terminate a policy solely by ending employment is not an incident of ownership and the value of the proceeds is not included in the gross estate. Further, if the employee had the right to convert a group policy into an individual insurance policy at the end of employment and could transfer this right, the proceeds of the policy are not included in the gross estate if the decedent irrevocably transferred both the policy and the conversion privilege to another. In this case, the decedent would have no control or incidents of ownership over the policy, because no action of the decedent could have affected the transferee's right to the proceeds.

If a policy is included in an estate because a decedent held an incident of ownership over it, it does not matter that the decedent did not initially take out the policy or that the decedent was physically unable to exercise control over the policy at the time of death.

Reversionary interest. Incidents of ownership includes a reversionary interest in the policy or its proceeds, but only if the value of the reversionary interest immediately before the death of the decedent was more than 5% of the value of the policy. This interest may arise by the specific terms of the policy or by operation of law. For this purpose, the term ***reversionary interest*** includes two possibilities:

1) That the policy or its proceeds may return to the decedent or the decedent's estate, and
2) That the policy or its proceeds may become subject to a power of disposition by the decedent.

See *Annuities, Life Estates, Terms for Years, Remainders, and Reversions,* for the method of determining the value of a reversionary interest.

Insurance proceeds paid to a divorced spouse. The gross estate includes life insurance proceeds paid directly to a decedent's former spouse if, under a decree of divorce, the decedent was required to name the divorced spouse as beneficiary of certain life insurance policies on the decedent's life and was required to maintain the policies until the former spouse's death or remarriage (at which time the proceeds would become payable to the decedent or the decedent's estate). However, a deduction is allowed from the gross estate as an indebtedness of the estate.

Example. Under the terms of a divorce decree by a court with power under local law to

decree a settlement of all marital property rights, John Black was required to name his wife as beneficiary of certain life insurance policies on his life. John was required to keep the policies in full force and effect until his death.

If John's wife remarries or dies before John dies, the policy proceeds would return to John or his estate, or they would be subject to a power of disposition. Thus, before death John held a reversionary interest that was more than 5% of the value of the policies.

After John's death, the proceeds were paid directly to John's former wife and never became part of the probate estate.

Since before death John held a reversionary interest of more than 5% of the value of the policies, the interest was an incident of ownership in the policies, and the value of the proceeds is includible in John's gross estate.

The estate, however, may deduct the amount of the proceeds paid to John's former wife. The requirement to pay the proceeds to John's former wife is an indebtedness against the property included in John's estate.

The terms ***reversionary interest*** and ***incidents of ownership*** do not apply to a policy or its proceeds that the decedent might inherit through the estate of another person, or as a surviving spouse under a statutory right of election or similar right.

If proceeds of life insurance are not includible in the gross estate under the provisions just discussed, they might still be includible under other provisions discussed in this section.

Form 706. The proceeds of life insurance on the decedent's life includible in the gross estate should be listed on Schedule D, Form 706. A copy of Form 712, *Life Insurance Statement*, prepared by the insurance company, should accompany the return for each policy on the decedent's life whether or not you include it in the gross estate.

Transactions Within 3 Years of Death

The gross estate of an individual who died before 1982 includes the value of property transferred by the decedent during the 3-year period ending on the date of the decedent's death.

Exceptions. The rule does not apply to:

1) Any bona fide sale for an adequate and full consideration in money or money's worth, and
2) Any gift (other than a life insurance policy) made during a calendar year if the decedent was not required to file a gift tax return for the gifts to that donee (recipient) because those gifts did not exceed the $3,000 ($10,000 beginning in 1982) annual exclusion for the calendar year.

Life insurance. If a decedent made a completed gift of a life insurance policy on his or her life within 3 years of death, the proceeds of the life insurance policy are included in the gross estate of the decedent. Therefore, if the decedent assigned all rights under the insurance policy to another person more than 3 years before death, the proceeds are not included in the gross estate. If the first assignment (made more than 3 years before death) of a group term life insurance policy is voided because of a change in the employer's insurance company and the new policy is assigned within 3 years of death, the proceeds are not included in the gross estate.

A gift of an insurance policy is considered to be made within 3 years of death if the decedent each year repurchases a policy that expires at the end of the policy year and reassigns it. In this case, the repurchase and reassignment constitutes a new transfer. However, the proceeds are not included in the gross estate if there is an option for an automatic renewal of a group term life insurance policy upon payment of the premium and if the policy was assigned more than 3 years before death.

Donee's basis. If a completed gift is included in the decedent's estate, the donee's (recipient's) basis may have to be recomputed.

Gift taxes. The gross estate also includes the amount of any gift tax paid by the decedent or the estate on any gift made by the decedent or the decedent's spouse during the 3-year period ending on the date of the decedent's death. This applies even if the gift is includible in the gross estate as a transfer within 3 years of death and under another section of the Code. The inclusion of the gift tax in the gross estate is not affected by the changes in the *After 1981* discussion, that follows.

After 1981. If a person dies after 1981, transfers made by that person before death will not be included in the gross estate. However, the transferred interest may still be included in the gross estate under one of the following:

1) Transfers with retained life estate,
2) Transfers taking effect at death,
3) Revocable transfers,
4) Powers of appointment, and
5) Proceeds of life insurance.

In addition, any transfers within 3 years of death will be used in figuring certain computations relating to:

1) Distributions in redemption of stock to pay death taxes,
2) Special valuation of certain farm, etc., real property,
3) Extension of time for payment of estate tax when the estate consists mainly of an interest in a closely held business, and
4) Estate tax liens.

Gifts made within the 3-year period for which a gift tax return was not required (exception (2), discussed earlier) are generally not included in the gross estate. For gifts made after 1981, the filing requirements for gift tax returns have been changed. These changes are fully discussed in the *Gift Tax* section of this publication. Under the new filing requirements, no gift tax return has to be filed for any gift to a spouse that qualifies for the marital deduction. If, however, that gift was made within 3 years of the donor's death, it will be included in the gross estate, for figuring the computations indicated above, even though no gift tax return was required to be filed.

Form 706. The value of the transfers within 3 years of death, including any gift tax paid, is listed on Schedule G, Form 706.

Certain Marital Deduction Property

After 1981. The executor of an estate of a person who died after 1981 may have elected the marital deduction for certain qualified terminable interest property that passed to the surviving spouse. If a gift of terminable interest property was made between spouses after 1981, the donor may have elected the marital deduction for that property if it qualified. To qualify, under either situation, the spouse who received the property must have a qualifying income interest for life in that property. (See *Marital Deduction*, under *Taxable Estate*, or *Marital Deduction* in the *Gift Tax* section of this publication, for a complete discussion.)

If the spouse who received the property dies, the value of any property in which the spouse had a qualifying income interest for life and for which a marital deduction was allowed, under either election, will be included in his or her gross estate. However, if all or part of the property had been disposed of before death, it will not be included in the gross estate.

Estate taxes recovered. If the gross estate includes the value of this marital deduction property, the estate may recover the estate tax on that property from whoever receives the property. See *Reimbursement of Estate Taxes*, discussed later.

Form 706. This property is listed on Schedule F, Form 706.

Valuation

Generally, the value of the decedent's property interest for estate tax purposes is its fair market value at the date of death or at the alternate valuation date. (See *Alternate Valuation*, discussed later.) Real property used in farming or other closely held businesses is eligible for a reduced valuation for estate tax purposes if the executor elects it. This special valuation is discussed in *Special Farm or Other Closely Held Business Real Property Valuation*.

The ***fair market value*** is the price at which the property would change hands between a willing buyer and a willing seller, if neither one is under any compulsion to buy or to sell and if both have reasonable knowledge of all relevant facts. The fair market value may not be determined by a forced sale price. It also may not be determined by the sale price in a market other than that in which the item is most commonly sold to the public. Thus, in the case of an item that is generally retailed, the fair market value is the price at which the item or a comparable item would be sold at retail.

Example. Automobiles are usually retailed, so the fair market value would be the retail value. The price a used car dealer would pay may not be used. If tangible personal property is sold through classified advertising in a newspaper, and if this is a common way of selling this kind of property, the selling price will be considered the retail sales price of the item at the time of the sale. This also applies to property sold at a public auction. This retail sales price also will be considered the retail sales price of the item on the applicable valuation date if the sale is made within a reasonable period following the valuation date and there is no substantial change in market conditions or other circumstances affecting the value of similar items between the time of the sale and the valuation date.

The following rules govern the valuation of particular types of property.

Unimproved Real Property

Unimproved real property is defined as land without significant buildings, structures, or any other improvements that contribute to its value.

Generally, the best indication of the value of unimproved real property is the price paid for the property in an arm's-length transaction on or before the valuation date. When the property has not recently been the subject of an arm's-length transaction, the best method of estimating value is by using the market data or comparable sales approach. This approach uses arm's-length sales of properties that are as similar as possible to the property being valued.

Comparable sales. In the comparable sales method a comparison is made between the property and other similar properties that have been sold. After the sales prices are adjusted for differences in date of sale, size, condition, and location, they reflect the estimated fair market value of the property to be valued.

With the comparable sales method, consider the following factors when inspecting the potential comparable property and the property to be valued:

1) Location, configuration, restrictions on use or zoning,
2) Accessibility and road frontage, available utilities and water rights,
3) Riparian rights, existing easements, rights of way, leases, etc.,
4) Soil characteristics, vegetative cover, status of mineral rights, and
5) Other factors affecting value.

In addition, take note of the names of the buyer and seller, the deed book and page number, the date of sale, sale price, property description, amount and terms of mortgages, property surveys, the assessed value, tax rate, and the assessor's appraised fair market value of the comparable properties.

The potential comparable sale price must be adjusted to account for differences between the sale property and the property to be valued. Since differences of opinions may arise as to the degree of comparability and the amount of the adjustment considered necessary for comparison purposes, document each item of adjustment.

Only comparable sales having the smallest adjustments in terms of items and/or total dollar adjustments should be considered as comparable to the property to be valued.

Stocks and Bonds

The value of stocks and bonds is their fair market value per unit (share or bond) on the applicable valuation date.

If there is a market for stocks and bonds on a stock exchange, in an over-the-counter market, or otherwise, the fair market value per unit is the mean (midpoint) between the highest and lowest quoted selling prices on the valuation date.

If there were no sales on the valuation date but there were sales on dates within a reasonable period before and after the valuation date, the fair market value is determined in the following way: take a weighted average of the mean between the highest and lowest sales prices on the nearest date before the valuation date, and the mean between the highest and lowest sales prices on the nearest date after the valuation date. The average must be weighted ***inversely*** by the respective numbers of trading days between the selling dates and the valuation date.

Example. The nearest transactions took place 2 trading days before the valuation date at a mean selling price of $10 and 3 trading days after the valuation date at a mean selling price of $15. The price of $12 is the fair market value, obtained by the following computation:

$$\frac{(3 \times \$10) + (2 \times \$15)}{5} = \$12$$

If no sales occurred within a reasonable period before and after the valuation date, the fair market value may be determined by taking the mean between the bona fide bid and asked prices on the valuation date, or if none, by taking a weighted average of the means between the bona fide bid and asked prices on the nearest trading date before, and the nearest trading date after, the valuation date. Both of these dates must be within a reasonable period.

If the highest and lowest selling prices on the valuation date are not available for bonds for which there is a market on a stock exchange, but the closing selling prices are available on the valuation date and the trading day before the valuation date, then the fair market value of the bond is the mean between the quoted closing selling price on the valuation date and the quoted closing selling price on the trading day before the valuation date.

If the stocks or bonds are listed on more than one exchange, the records of the exchange where the stocks or bonds are principally dealt in should be used to value the stocks and bonds if the records are available in a generally available listing or publication of general circulation. If these records are not available and the stocks and bonds are in a composite listing of combined exchanges that is generally available then use the records of the combined exchanges.

If no actual sale prices or bona fide bid and asked prices are available on a date within a reasonable period before the valuation date, but are available on a date within a reasonable period after the valuation date, or vice versa, then the mean between the highest and lowest available sale prices or bid and asked prices on that date may be taken as the fair market value.

Closely held corporation. If selling prices or bid and asked prices are not available under the preceding conditions, or if securities of a closely held corporation are involved, determine the fair market value by taking the following factors into consideration:

1) In the case of bonds, the soundness of the security, the interest yield, the date of maturity, and other relevant factors, and
2) In the case of shares of stock, the company's net worth, prospective earning power and dividend-paying capacity, and other relevant factors.

Some of the ***other relevant factors*** are the goodwill of the business, the economic outlook in the particular industry, the company's position in the industry, the degree of control represented by the block of stock to be valued, and the value of securities of other corporations engaged in the same or similar lines of business that are listed on a stock exchange.

Stock selling ex-dividend. If a dividend was declared before the valuation date and was payable after that date, and if the stock was selling ex-dividend on the valuation date, determine the fair market value of the stock by adding the amount of the dividend to the ex-dividend quotation. If the decedent died on a weekend and the stock began selling ex-dividend on the following trading day, determine the weighted average by adding the value of the dividend to the mean of the ex-dividend quotations.

Restricted securities. Some securities cannot be immediately resold by the holder because they are restricted from resale under federal securities laws. The securities are sometimes called "restricted securities," "unregistered securities," "investment letter stock," or "private placement stock."

Valuation. In valuing restricted shares, the securities industry uses the following methods to determine the fair market value.

1) Current market price of the unrestricted stock minus a constant precentage ***discount*** based on purchase discount,
2) Current market price of unrestricted stock minus a constant percentage ***discount*** different from purchase discount,
3) Current market price of the unrestricted stock minus a ***discount*** amortized over a fixed period,
4) Current market price of the unrestricted stock, and
5) Cost of the restricted stock until it is registered.

Discount. The following factors are considered in determining the amount of discount mentioned above. Some factors may carry more weight than others.

1) Earnings, net assets, and net sales must be given primary consideration in arriving at the discount for restricted securities from freely traded shares. Depending on the type of business activity, one of the elements may be given more weight than others.
2) Resale provisions found in the restriction agreements must be weighed to determine the discount to apply to the fair market value of the company. For instance, the longer a buyer of shares must wait to liquidate the stock, the greater the discount.
3) The negotiation strengths of the buyer and seller affect the amount of the discount. For instance, a tight money market may cause the buyer to have the better bargaining position.
4) The market experience of freely tradable securities of the same class as the restricted securities is significant in determining the discount. For instance, shares traded on a public market generally are worth more to investors than those that are not traded on a public market.

All relevant facts and circumstances that bear upon the worth of restricted stock, including those set forth above, must be taken into account in arriving at the fair market value of the securities.

Flower bonds. So-called "flower bonds" are marketable United States Treasury bonds that can be redeemed by an executor at par value plus accrued interest to pay federal estate taxes. These bonds are included in the gross estate at par value, even if the market value is less than par. If the market value is greater than par, they are included in the gross estate at the mean between the highest and lowest quoted selling prices. The gross estate will include the par value of flower bonds that could have been applied toward a part of the estate tax even if they are not used to pay the estate tax and are sold on the market at less than par value.

Shares in Mutual Funds

The fair market value of a share in an open-end investment company (commonly known as a mutual fund) is the redemption price (bid price) on the date of death, or alternate valuation date. If there is no public redemption price quoted by the company for the applicable valuation date, the fair market value of the mutual fund share is the last public redemption price quoted by the company for the first day before the applicable valuation date for which there is a quotation.

Interest in Business

The fair market value of a decedent's interest in a business is the net amount that a willing purchaser would pay for the interest to a willing seller, when neither is under any compulsion to buy or sell and both have reasonable knowledge of relevant facts. This applies both for sole proprietorships and for partnerships.

The net value is determined on the basis of all relevant factors, including:

1) A fair appraisal of all the assets of the business,
2) The demonstrated earning capacity of the business, and
3) Other applicable factors used in considering the value of corporate stock.

In certain cases special attention should be given to determining an adequate value of the goodwill of the business. This would apply, for example, if the decedent is a partner who has not agreed that, for an adequate and full consideration in money or money's worth, the interest passes at death to a surviving partner or partners. Include complete financial and other data supporting this valuation with the return.

Annuities, Life Estates, Terms for Years, Remainders, and Reversions

The value of an annuity, or of a life insurance policy on the life of a person other than the decedent, issued by a company regularly engaged in the selling of such contracts, is the amount that the issuing company would charge for a comparable contract on the date of the decedent's death.

An annuity payable under a combination annuity and life insurance policy on a decedent's life that had no insurance element at the time of death is treated as a contract for the payment of an annuity.

An insurance policy on a decedent's life that is includible in the gross estate, as described earlier in *Proceeds of Life Insurance*, has a value equal to the proceeds payable by the policy.

The value of all annuities, life estates, terms for years, remainders, or reversions other than those already described, is the ***present value*** on the applicable valuation date.

To compute the present value of an annuity, life estate, remainder, or reversion that is dependent upon the continuation or termination of any one life, Table A should be used. For purposes of the table, the age of a person is the age attained at the birthday nearest to the valuation date. This table is used only if the decedent died after 1970, and if just one life is involved. If the rights to be valued depend upon the lives of two or more persons, other tables must be used.

These tables are shown in the following Internal Revenue publications:

Publication 723, *Valuation of Last Survivor Charitable Remainders;*

Publication 723A, *Factors at 6 Percent Involving One and Two Lives;*

Supplement 1 to Publication 723A;

Publication 723B, *Two-Life Tables for Unitrusts and Pooled Income Funds.*

These publications are available from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Supplement 1 to Publication 723A contains factors for valuing a spouse's rights in a tenancy by the entirety, when each spouse is entitled to one-half the income while both are living. It also provides a table for evaluating the present worth of the right to receive the use of $1 for a term of 10 to 11 years or until the prior death of a person (male or female) of stated age.

Publication 723B contains two-life, last-to-die factors for valuing the remainder interest in charitable remainder unitrusts and pooled income funds. The adjusted payout rates for the unitrusts range from 4.6% to 12.4% in intervals of 0.2%. The yearly rates of return for pooled income funds extend from 2.2% to 10.0% in intervals of 0.2%. Both tables give all possible combinations for males and females from ages 30 through 90.

For two-life situations not covered in Publication 723B, or for three or more lives, use the method and tables shown in Publication 723. The Internal Revenue Service may supply the factor upon request. See the procedures for requesting actuarial factors at the end of this publication.

Payments at end of period. If annuity payments are made annually at the end of each year, do not modify the annuity factors in Table A or any annuity factors derived from the other publications. If an annuity is payable at the end of semiannual, quarterly, monthly, or weekly periods during the life of an individual or for a term of years, multiply the annual amount to be paid by the annuity factor. Multiply the result by whichever of the following factors applies:

1.0148 for semiannual payments;
1.0222 for quarterly payments;
1.0272 for monthly payments; or
1.0291 for weekly payments.

If the property interest depends on a term certain (definite number of years) rather than on a life or lives, figure its present value using Table B. If payments are made semiannually, quarterly, monthly, or weekly, use the adjustment factors shown in the preceding paragraph.

Payments at beginning of period. If the first payment of an annuity for a term certain is due at the beginning of the annual period or other payment period, multiply the annual amount to be paid by the appropriate annuity factor from Table B. Multiply the result by whichever of the following factors applies:

1.0600 for annual payments;
1.0448 for semiannual payments;
1.0372 for quarterly payments;
1.0322 for monthly payments; or
1.0303 for weekly payments.

If the first payment of an annuity for the life of an individual is due at the beginning of the annual or other payment period, the value of the annuity is the sum of the first payment plus the present value of an annuity as determined under *Payments at end of period*.

Alternate Valuation

As executor, you may elect to use the alternate valuation method. Under this method, property included in the decedent's gross estate is valued as of a date other than that of death. This election does not change the rule that the gross estate includes property that the decedent owned or had an interest in at the date of death. You must make the election on the estate tax return filed within 9 months of the date of death or within the period of any extension of time granted for filing such return. You cannot make or change the election after that period.

The purpose of this method is to permit a reduction of the tax liability if the total value of the estate's property has decreased. But it may be used whether or not a decrease has occurred. The election, however, is effective only if a return is required to be filed. The election applies to ***all of the property in the estate***; it cannot be used for only part of the property.

Under the alternate valuation method, any deduction is allowed only to the extent it is not otherwise allowed in determining the value of the gross estate. In addition, if a charitable deduction is expressed as a percentage of the gross estate, the alternate value of the gross estate would be used in computing the charitable deduction.

Alternate valuation rules. If you elect the alternative valuation method, property in the estate is valued according to the following rules:

1) Any property distributed, sold, exchanged, or otherwise disposed of within 6 months after the decedent's death is valued as of the date on which it is first distributed, sold, exchanged, or otherwise disposed of.
2) Any property not disposed of within 6 months after the decedent's death is valued as of 6 months after the date of the decedent's death.
3) Any property, interest, or estate that is affected by mere lapse of time is valued as of the date of the decedent's death. However, this is adjusted for any difference in value not due to mere lapse of time as of 6 months after the decedent's death, or, if earlier, as of the date of its disposition.

Properties, interests, or estates that are ***affected by mere lapse of time*** include patents, estates for the lives of persons other than the decedent, remainders, and reversions. This term does not apply to obligations for the payment of money, whether or not interest bearing, the value of which changes with the passing of time. Following are examples of rule 3.

Example 1. Al Brown has a life estate in certain property, that is, the right to receive the income from the property as long as he lives. Al's brother Bob has a remainder interest in fee in the same property; that is, Bob or his estate will receive the property after Al's death.

Bob died when Al was 31 years old (calculated to his nearest birthday). On the date of Bob's death, the fair market value of the property was $50,000. The value of the remainder interest in this property is includible in Bob's gross estate.

The value of the estate's remainder interest in this property is computed using the factor taken

Table A

Male				Female			
1 Age	2 Annuity	3 Life Estate	4 Remainder	1 Age	2 Annuity	3 Life Estate	4 Remainder
0	15.6175	.93705	.06295	0	15.8972	.95383	.04617
1	16.0362	.96217	.03783	1	16.2284	.97370	.02630
2	16.0283	.96170	.03830	2	16.2287	.97372	.02628
3	16.0089	.96053	.03947	3	16.2180	.97308	.02692
4	15.9841	.95905	.04095	4	16.2029	.97217	.02783
5	15.9553	.95732	.04268	5	16.1850	.97110	.02890
6	15.9233	.95540	.04460	6	16.1648	.96989	.03011
7	15.8885	.95331	.04669	7	16.1421	.96853	.03147
8	15.8508	.95105	.04895	8	16.1172	.96703	.03297
9	15.8101	.94861	.05139	9	16.0910	.96541	.03459
10	15.7663	.94598	.05402	10	16.0608	.96365	.03635
11	15.7194	.94316	.05684	11	16.0293	.96176	.03824
12	15.6698	.94019	.05981	12	15.9958	.95975	.04025
13	15.6180	.93708	.06292	13	15.9607	.95764	.04236
14	15.5651	.93391	.06609	14	15.9239	.95543	.04457
15	15.5115	.93069	.06931	15	15.8856	.95314	.04686
16	15.4576	.92746	.07254	16	15.8460	.95076	.04924
17	15.4031	.92419	.07581	17	15.8048	.94829	.05171
18	15.3481	.92089	.07911	18	15.7620	.94572	.05428
19	15.2918	.91751	.08249	19	15.7172	.94303	.05697
20	15.2336	.91403	.08597	20	15.6701	.94021	.05979
21	15.1744	.91046	.08954	21	15.6207	.93724	.06276
22	15.1130	.90678	.09328	22	15.5687	.93412	.06588
23	15.0487	.90292	.09702	23	15.5141	.93085	.06915
24	14.9807	.89884	.10116	24	15.4565	.92739	.07261
25	14.9075	.89445	.10555	25	15.3959	.92375	.07625
26	14.8287	.88972	.11028	26	15.3322	.91993	.08007
27	14.7442	.88465	.11535	27	15.2652	.91591	.08409
28	14.6542	.87925	.12075	28	15.1946	.91168	.08832
29	14.5588	.87353	.12647	29	15.1208	.90725	.09275
30	14.4584	.86750	.13250	30	15.0432	.90259	.09741
31	14.3528	.86117	.13883	31	14.9622	.89773	.10227
32	14.2418	.85451	.14549	32	14.8775	.89265	.10735
33	14.1254	.84752	.15248	33	14.7888	.88733	.11267
34	14.0034	.84020	.15980	34	14.6960	.88176	.11824
35	13.8758	.83255	.16745	35	14.5989	.87593	.12407
36	13.7425	.82455	.17545	36	14.4975	.86985	.13015
37	13.6036	.81622	.18378	37	14.3915	.86349	.13651
38	13.4591	.80755	.19245	38	14.2811	.85687	.14313
39	13.3090	.79854	.20146	39	14.1663	.84998	.15002
40	13.1538	.78923	.21077	40	14.0468	.84281	.15719
41	12.9934	.77960	.22040	41	13.9227	.83536	.16464
42	12.8279	.76967	.23033	42	13.7940	.82764	.17236
43	12.6574	.75944	.24056	43	13.6604	.81962	.18038
44	12.4819	.74891	.25109	44	13.5219	.81131	.18869
45	12.3013	.73808	.26192	45	13.3781	.80269	.19731
46	12.1158	.72695	.27305	46	13.2290	.79374	.20626
47	11.9253	.71552	.28448	47	13.0746	.78448	.21552
48	11.7308	.70385	.29615	48	12.9147	.77488	.22512
49	11.5330	.69198	.30802	49	12.7496	.76498	.23502
50	11.3329	.67997	.32003	50	12.5793	.75476	.24524
51	11.1308	.66785	.33215	51	12.4039	.74423	.25577
52	10.9267	.65560	.34440	52	12.2232	.73339	.26661
53	10.7200	.64320	.35680	53	12.0367	.72220	.27780
54	10.5100	.63060	.36940	54	11.8436	.71062	.28938
55	10.2960	.61776	.38224	55	11.6432	.69859	.30141

Table A

Male				Female			
1 Age	2 Annuity	3 Life Estate	4 Remainder	1 Age	2 Annuity	3 Life Estate	4 Remainder
56	10.0777	.60466	.39534	56	11.4353	.68612	.31388
57	9.8552	.59131	.40869	57	11.2200	.67320	.32680
58	9.6297	.57778	.42222	58	10.9980	.65988	.34012
59	9.4028	.56417	.43583	59	10.7703	.64622	.35378
60	9.1753	.55052	.44948	60	10.5376	.63226	.36774
61	8.9478	.53687	.46313	61	10.3005	.61803	.38197
62	8.7202	.52321	.47679	62	10.0587	.60352	.39648
63	8.4924	.50954	.49046	63	9.8118	.58871	.41129
64	8.2642	.49585	.50415	64	9.5592	.57355	.42645
65	8.0353	.48212	.51788	65	9.3005	.55803	.44197
66	7.8060	.46836	.53164	66	9.0352	.54211	.45789
67	7.5763	.45458	.54542	67	8.7639	.52583	.47417
68	7.3462	.44077	.55923	68	8.4874	.50924	.49076
69	7.1149	.42689	.57311	69	8.2068	.49241	.50759
70	6.8823	.41294	.58706	70	7.9234	.47540	.52460
71	6.6481	.39889	.60111	71	7.6371	.45823	.54177
72	6.4123	.38474	.61526	72	7.3480	.44088	.55912
73	6.1752	.37051	.62949	73	7.0568	.42341	.57659
74	5.9373	.35624	.64376	74	6.7645	.40587	.59413
75	5.6990	.34194	.65806	75	6.4721	.38833	.61167
76	5.4602	.32761	.67239	76	6.1788	.37073	.62927
77	5.2211	.31327	.68673	77	5.8845	.35307	.64693
78	4.9825	.29895	.70105	78	5.5910	.33546	.66454
79	4.7469	.28481	.71519	79	5.3018	.31811	.68189
80	4.5164	.27098	.72902	80	5.0195	.30117	.69883
81	4.2955	.25773	.74227	81	4.7482	.28489	.71511
82	4.0879	.24527	.75473	82	4.4892	.26935	.73065
83	3.8924	.23354	.76646	83	4.2398	.25439	.74561
84	3.7029	.22217	.77783	84	3.9927	.23956	.76044
85	3.5117	.21070	.78930	85	3.7401	.22441	.77559
86	3.3259	.19955	.80045	86	3.5016	.21010	.78990
87	3.1450	.18820	.81130	87	3.2790	.19674	.80326
88	2.9703	.17872	.82178	88	3.0719	.18431	.81569
89	2.8052	.16831	.83169	89	2.8808	.17285	.82715
90	2.6536	.15922	.84078	90	2.7068	.16241	.83759
91	2.5162	.15097	.84903	91	2.5502	.15301	.84699
92	2.3917	.14350	.85650	92	2.4116	.14470	.85530
93	2.2801	.13681	.86319	93	2.2901	.13741	.86259
94	2.1802	.13081	.86919	94	2.1839	.13103	.86897
95	2.0891	.12535	.87465	95	2.0891	.12535	.87465
96	1.9997	.11998	.88002	96	1.9997	.11998	.88002
97	1.9145	.11487	.88513	97	1.9145	.11487	.88513
98	1.8331	.10999	.89001	98	1.8331	.10999	.89001
99	1.7554	.10532	.89468	99	1.7554	.10532	.89468
100	1.6812	.10087	.89913	100	1.6812	.10087	.89913
101	1.6101	.09661	.90339	101	1.6101	.09661	.90339
102	1.5416	.09250	.90750	102	1.5416	.09250	.90750
103	1.4744	.08846	.91154	103	1.4744	.08846	.91154
104	1.4065	.08439	.91561	104	1.4065	.08439	.91561
105	1.3334	.08000	.92000	105	1.3334	.08000	.92000
106	1.2452	.07471	.92529	106	1.2452	.07471	.92529
107	1.1196	.06718	.93282	107	1.1196	.06718	.93282
108	.9043	.05426	.94574	108	.9043	.05426	.94574
109	.4717	.02830	.97170	109	.4717	.02830	.97170

Table B

1 Number of Years	2 Annuity	3 Term Certain	4 Remainder	1 Number of Years	2 Annuity	3 Term Certain	4 Remainder
1	0.9434	.056604	.943396	31	13.9291	.835745	.164255
2	1.8334	.110004	.889996	32	14.0840	.845043	.154957
3	2.6730	.160381	.839619	33	14.2302	.853814	.146186
4	3.4651	.207906	.792094	34	14.3681	.862088	.137912
5	4.2124	.252742	.747258	35	14.4982	.869895	.130105
6	4.9173	.295039	.704961	36	14.6210	.877259	.122741
7	5.5824	.334943	.665057	37	14.7368	.884207	.115793
8	6.2098	.372588	.627412	38	14.8460	.890761	.109239
9	6.8017	.408102	.591898	39	14.9491	.896944	.103056
10	7.3601	.441605	.558395	40	15.0463	.902778	.097222
11	7.8869	.473212	.526788	41	15.1380	.908281	.091719
12	8.3838	.503031	.496969	42	15.2245	.913473	.086527
13	8.8527	.531161	.468839	43	15.3062	.918370	.081630
14	9.2950	.557699	.442301	44	15.3832	.922991	.077009
15	9.7122	.582735	.417265	45	15.4558	.927350	.072650
16	10.1059	.606354	.393646	46	15.5244	.931462	.068538
17	10.4773	.628636	.371364	47	15.5890	.935342	.064653
18	10.8276	.649656	.350344	48	15.6500	.939002	.060998
19	11.1581	.669487	.330513	49	15.7076	.942454	.057546
20	11.4699	.688195	.311805	50	15.7619	.945712	.054288
21	11.7641	.705845	.294155	51	15.8131	.948785	.051215
22	12.0416	.722495	.277505	52	15.8614	.951684	.048316
23	12.3034	.738203	.261797	53	15.9070	.954418	.045582
24	12.5504	.753021	.246979	54	15.9500	.956999	.043001
25	12.7834	.767001	.232999	55	15.9905	.959433	.040567
26	13.0032	.780190	.219810	56	16.0288	.961729	.038271
27	13.2105	.792632	.207368	57	16.0649	.963895	.036105
28	13.4062	.804370	.195630	58	16.0990	.965939	.034061
29	13.5907	.815443	.184557	59	16.1311	.967867	.032133
30	13.7648	.825890	.174110	60	16.1614	.969686	.030314

from Table A for remainder interests (column 4) for males, age 31. This factor is .13883.

If the executor does not elect the alternate valuation date, the value of the remainder interest in the property for estate tax purposes is $6,941.50 ($50,000 × .13883).

If the executor elects the alternate valuation date and if the property declined $10,000 in value because of economic conditions, the value of the remainder interest would be $5,553.20 ($40,000 × .13883). This would apply even if Al were 32 years old on the alternate valuation date.

Note. If the alternate valuation method is used, the values of life estates, remainders, and similar interests are figured by using the ages of the recipients on the date of the decedent's death and the value of the property on the alternate valuation date.

Example 2. Bernard Jones owned a patent that had a value at the date of his death of $78,000 and an unexpired term of 10 years. Three months after Bernard's death, the patent was sold for $60,000. This price was due to the lapse of time and other factors. To determine the value of the patent includible in the gross estate under the alternate valuation method, an adjustment to the selling price must be made to reflect the change in value attributable solely to the lapse of 3 months. To figure this alternate value, divide $60,000 by .975 (the ratio of the remaining life of the patent on the valuation date (9.75 years) to the remaining life at the date of death (10 years)). Thus, the includible amount is $61,538.46. Note that Tables A and B were not used for this computation.

Mutual fund capital gain dividends. When a capital gain dividend is declared and paid by a regulated investment company on its stock between the date of the decedent's death and the alternate valuation date, it is not includible in computing the value of the decedent's gross estate on the alternate valuation date. This rule applies if the value of the shares of the stock on the alternate valuation date ***reasonably represent*** the same included property of the gross estate as existed at the date of death.

Special Farm or Other Closely Held Business Real Property Valuation

As the executor of an estate, you may elect to value qualified real property that is included in the decedent's estate and that is devoted to farming, or is used in a closely held business, on the basis of its actual use for these purposes, rather than its fair market value determined on any other basis. Property passing in trust and property owned indirectly through a corporation or partnership qualify for this special-use valuation.

The decedent must have been a citizen or resident of the United States at the time of death and the property must be located in the United States.

The election does not have to cover all qualified real property included in the estate. However, there are percentage requirements that must be met. If you exclude property from the election, the property valued under this method must meet the percentage requirements.

Limitation. The total decrease in the value of qualified real property for which this election applies cannot be more than $600,000 for the estate of a person who died in 1981.

After 1981. The limitation for the estate of a person who dies in 1982 is $700,000. If a person dies after 1982, the limitation is $750,000.

Community property rules. If the decedent and the decedent's spouse at any time held qualified real property as community property, the special-use valuation rules apply as if the property were not community property. Therefore, the community shares of both spouses are combined both for determining if the required portions of the decedent's estate consist of qualified property and for purposes of the total decrease in value of qualified real property.

General Requirements

The property must have been ***qualified real property*** used for a ***qualified use*** by the decedent or a member of the decedent's family on the date of the decedent's death, and:

1) At least 50% of the ***adjusted value*** of the gross estate must consist of the adjusted value of real or personal property that was being used as a farm or in a closely held business and that was acquired from, or passed from, the decedent to a qualified heir of the decedent,
2) At least 25% of the adjusted value of the gross estate must consist of the adjusted value of qualified farm or closely held business real property,
3) The decedent or a member of the decedent's family must have owned the qualifying

real property and must have used it for a qualified use for periods totaling at least 5 years out of the 8–year period ending on the date of the decedent's death, and

4) There must have been ***material participation*** in the operation of the farm or closely held business by the decedent or by a member of the decedent's family for periods totaling at least 5 years out of the 8–year period ending on the date of the decedent's death.

Adjusted value. For purposes of (1) and (2) the adjusted value is the value of property determined without regard to its special-use value. The value is reduced for unpaid mortgages on the property or any indebtedness against the property, if the full value of the decedent's interest in the property (not reduced by such mortgage or indebtedness) is included in the value of the gross estate.

Qualified Real Property

For real property to qualify for this special-use valuation, a ***qualified heir,*** must receive or acquire it from the decedent. It does not matter whether the real property is owned by the decedent directly or indirectly through ownership of an interest in a corporation, a partnership, or a trust. If the ownership is indirect, the decedent's interest in the business must qualify under the requirements as discussed in this section, and:

1) If the indirect ownership is through a corporation—
   a) At least 20% of the value of the corporation's voting stock must be included in the gross estate, or
   b) The corporation must have had no more than 15 shareholders; or
2) If the indirect ownership is through a partnership—
   a) At least 20% of the partnership's total capital interest must be included in the gross estate, or
   b) The partnership must have had no more than 15 partners;

and therefore qualify as an interest in a closely held business on the date of the decedent's death and for a period of time that equals (when combined with periods of direct ownership) at least 5 of the 8 years preceding death. All specially valued property must be used in a trade or business.

When directly owned real property is leased by a decedent to a separate closely held business, it is considered to be qualified real property if the separate business qualifies as a closely held business with respect to the decedent, as discussed above, on the date of death and for a period of time that equals (when combined with periods during which the property was operated as a proprietorship) at least 5 of the 8 years preceding death. For example, real property owned by the decedent is eligible for the special-use valuation when it is leased to a farming corporation or partnership owned and operated entirely by the decedent and fewer than 15 members of the decedent's family.

For the special-use valuation, the term trade or business applies only to an active business such as a manufacturing, mercantile, or service enterprise, or to the raising of agricultural or horticultural commodities. It does not apply to passive investment activities or the mere passive rental of property to a party other than a member of the decedent's family. The decedent or a member of the decedent's family must own an equity interest in the farm operation. No trade or business is present in the case of activities not engaged in for profit.

Structures and other real property improvements. Qualified real property includes residential buildings and other structures and real property improvements regularly occupied or used by the owner or lessee of real property (or by employees of the owner or lessee) to operate the farm or business. If a farm residence is occupied by the decedent owner of the specially valued property, it is considered to be occupied for the purpose of operating the farm even when a family member and not the decedent was the person materially participating in the operation of the farm.

Qualified real property also includes roads, buildings, and other structures, and improvements functionally related to the qualified use. However, elements of value, such as mineral rights and hunting rights, that are not related to the farm or business use are not eligible for special-use valuation.

Property acquired from the decedent. Property is considered to have been acquired from, or to have passed from, the decedent if one of the following applies:

1) The property is considered acquired from the decedent under section 1014(b) of the Code (relating to basis of property acquired from a decedent).
2) The property is acquired by any person from the estate.
3) The property is acquired by any person from a trust, to the extent the property is includible in the gross estate.

Qualified heir. A person is a qualified heir of property, if he or she is a member of the decedent's family and acquired or received the property from the decedent. If a qualified heir or heiress disposes of any interest in qualified real property to any member of his or her family, that person will then be treated as the qualified heir with respect to the interest.

Member of the family. The term "member of the family" applies only to an individual's ancestor or lineal descendant, a lineal descendant of the individual's grandparent, the individual's spouse, or the spouse, widow, or widower of a descendant. A legally adopted child is considered a child by blood, but a stepchild is not.

After 1981. The term "member of the family" has been changed for the estate of a person dying after 1981. For these estates, member of the family includes only:

1) An ancestor (parent, grandparent, etc.) of the individual,
2) The spouse of the individual,
3) A lineal descendant (child, stepchild, grandchild, etc.) of the individual, the individual's spouse, or a parent of the individual, or
4) The spouse, widow, or widower of any lineal descendant described above.

A legally adopted child of an individual is treated as a child of that individual by blood.

Discretionary trust. Property transferred to a discretionary trust is eligible for the special-use valuation if all the potential beneficiaries of the trust are qualified heirs and the other requirements discussed in this section are met.

Qualified use. The term "qualified use" means the use of property as a farm for farming purposes or the use of property in a trade or business other than farming. The mere passive rental of property to a party other than a member of the decedent's family does not qualify. However, if the decedent's trade or business leases the property and conducts farming or other business activities on the property, the real property may qualify for the special-use valuation. A net lease to any party other than an entity that is the decedent's trade or business is not a qualified use.

In general, ***farms*** include stock, dairy, poultry, fruit, furbearing animal, and truck farms, plantations, ranches, nurseries, ranges, and greenhouses or other similar structures used primarily for raising agricultural or horticultural commodities. Farms also include orchards and woodlands.

The term "farming purposes" means:

1) Cultivating the soil or raising or harvesting any agricultural or horticultural commodity on a farm including raising, shearing, feeding, caring for, training, and managing animals,
2) Handling, drying, packing, grading, or storing on a farm any agricultural or horticultural commodity in its unmanufactured state, but only if the owner, tenant, or operator of the farm regularly produces more than one-half of the commodity so treated, and
3) Planting, cultivating, caring for, or cutting trees, or preparing (other than milling) trees for market.

Real property that is used in a ***trade or business*** other than farming may also qualify if the property was used in a trade or business in which the decedent or a member of the decedent's family materially participated before the decedent's death. This is true even if the party carrying on the business was not the decedent or a member of the family. However, the decedent or a member of the family must have personally and materially participated in the operation of the business and the decedent must have owned an interest in the business.

Period property must be owned. To be valued in this manner, the real property must be actually owned by any combination of the decedent, members of the decedent's family, and qualified closely held businesses for periods totaling at least 5 of the 8 years preceding the date of decedent's death. For example, if replacement property was acquired in a like-kind exchange before 1982, it was considered to be owned only from the date on which the replacement property was actually acquired. On the other hand, if replacement property is acquired as a result of an involuntary conversion in a transfer that would meet certain requirements if it occurred after the date of the decedent's death, it is considered to have been owned from the date on which the involuntarily converted property was acquired.

If property is transferred from a proprietorship to a corporation or a partnership during the 8–year period ending on the date of the decedent's death, it is considered to be continuously owned to the extent of the decedent's equity interest in the corporation or partnership. But this applies only if the transfer meets the requirements of a nontaxable transfer to a corporation controlled by the transferor (section 351), or of the nonrecognition of gain or loss on a contribution to a partnership (section 721), and the decedent's interest in the corporation or partnership meets the requirements for indirectly held property as discussed at the beginning of *Qualified Real Property*.

Property transferred to a trust also is considered to be continuously owned if the beneficial ownership of the trust property is such that the requirements for indirect ownership of property through a corporation (discussed earlier) would be satisfied if the property were owned by a corporation and all beneficiaries having vested interests in the trust were shareholders in the corporation.

You may not count any periods following the transfer during which the interest in a corporation, partnership, or trust does not meet the indirect ownership requirements.

After 1981—treatment of replacement property. For the estate of a person who died after 1981, the period of the decedent or family member's ownership, qualified use, or material participation (discussed next) with respect to replaced property is treated as the period of ownership, qualified use, or material participation with respect to the qualified replacement property. This applies only to that part of the fair market value of the qualified replacement property (at the date of acquisition) that does not exceed the fair market value of the replaced property (at date of disposition).

Property is ***qualified replacement property*** if it is acquired in a like-kind exchange or is acquired because of an involuntary conversion. This includes only property that is used for the same qualified use as that of the replaced property before the exchange. ***Replaced property*** is the property transferred in a like-kind exchange or involuntarily converted.

Example. Karen Ash had owned two tracts of land that were qualified real property. She acquired tract A in 1975 and tract B in 1979. Both tracts were condemned for public use in 1980. Karen received $100,000 for tract A and $50,000 for tract B. She used the total proceeds to purchase tract C, a single tract of land, as qualified replacement property.

To determine Karen's period of ownership for tract C, allocate the condemnation proceeds received for each tract to the total purchase price of the replacement property. The proceeds from tract A ($100,000) equals two-thirds of the total purchase price ($150,000). Therefore, two-thirds of tract C is considered replacement property of tract A. Karen is considered to have owned two-thirds of tract C since 1975. Under this method one-third of tract C is considered replacement property of tract B. Therefore, one-third of tract C is considered owned since 1979.

Therefore, if Karen dies in 1982, she would meet the ownership requirements for special-use valuation for only two-thirds of tract C. The same apportionment method applies in determining whether the material participation and qualified use requirements are met.

Material Participation

For the special valuation rules to apply, the deceased owner or a member of the owner's family or both must materially participate in the operation of the farm or other business. Material participation is a finding of fact. The types of activities and financial risks that will support such a finding will vary with the type of ownership of both the property itself and of any business in which it is used. Passively collecting rents, salaries, draws, dividends, or other income from the farm or other business is not material participation. Neither is merely advancing capital and reviewing a crop plan or other business proposal and financial reports each season or business year.

Period of material participation. The required participation must last:

1) For periods totaling at least 5 years during the 8 years immediately before the date of death, and
2) For periods totaling at least 5 years during any 8-year period ending after the date of the decedent's death, but within the 10- or 15-year period after the decedent's death. (These periods are discussed later and depend on the year of death.)

In determining whether the material participation requirement is satisfied, no exception is made for periods during which the decedent's estate holds the real property. Additionally, if two or more family members materially participate at the same time during a period totaling a year, that will not result in the year being counted as 2 or more years for purposes of satisfying the above requirements.

If a qualified heir dies before the required period has passed, any material participation requirement ends for that heir's portion of the property if the heir received a separate, joint, or other undivided property interest from the decedent. If qualified heirs receive successive interests in specially valued property (for example, life estate and remainder interests) from the decedent, the material participation requirement does not end for any part of the property until the death of the last qualified heir (or, if earlier, the expiration of the 10- or 15-year period from the date of the decedent's death). The requirements will fully apply to an heir's estate if the heir's executor made an election for the same property.

In determining whether the required participation has occurred, disregard brief periods (30 days or less) during which there was no material participation. But you may disregard them only if these periods were both preceded and followed by substantial periods (more than 120 days) in which there was uninterrupted material participation. See *Required activities for material participation*, discussed later, which provides a special rule for periods when little or no activity is necessary to fully manage a farm.

After 1981. The period of material participation by a decedent (at least 5 years out of the 8-year period ending on the date of death) is changed in the following situation for the estate of a person who dies after 1981.

Retired or disabled. If, on the date of death, the time period for material participation could not be met because the decedent had retired or was disabled, a substitute period may apply. This substitute period applies only if the decedent was retired on social security or was disabled for a continuous period ending with death. The time period for material participation for these decedents is a period totaling at least 5 years out of the 8-year period ending on the earlier of (1) the date that person began receiving social security benefits, or (2) the date that person became disabled. A person is disabled if the person is mentally or physically unable to materially participate in the operation of the farm or other business.

Required activities for material participation. To constitute material participation, the actual employment of the decedent or a member of the decedent's family must be substantially full-time. This means 35 hours a week or more or enough time to personally fully manage the farm or business in which the real property is used. For many farming operations that require only seasonal activity, material participation exists as long as all necessary functions are performed even though little or no actual activity occurs during nonproducing seasons. In the absence of this direct involvement in the farm or other business, the activities of either the decedent or family members must meet the standards prescribed in this discussion and subject the person to self-employment tax.

If participants are self-employed with respect to the farm or other trade or business, their income from the farm or other business must be earned income for purposes of the tax on self-employment income before they are considered to be materially participating. Payment of the self-employment tax does not in itself indicate material participation. If no self-employment taxes have been paid, however, no material participation is considered to have occurred unless the executor demonstrates to the satisfaction of the Internal Revenue Service that material participation did in fact occur and informs the Service of the reason why no tax was paid. In addition, all self-employment taxes (including interest and penalties) determined to be due must be paid.

In determining whether the material participation requirement is satisfied, the activities of each participant are considered separately from the activities of all other participants. At any given time the activities of at least one participant must be material. If the involvement is less than full-time, it must be according to an arrangement. The arrangement must provide for actual participation in the production or management of production in which the land is used by any nonfamily member, trust, or business entity in farming or another business. The arrangement may be oral or written, but must be in an arrangement that can be proven. Activities not called for by the arrangement will not support a finding of material participation. Activities of any agent or employee other than a family member may not be considered in determining if material participation exists. Activities of family members are considered only if the family relationship existed at the time the activities occurred.

No one factor brings about the existence of material participation, but physical work and participation in management decisions are the principal factors to be considered.

The decedent or family member must regularly advise or consult with the other managing party on the operation of the business. While they need not make all final management decisions alone, the decedent or family member must participate in making a substantial number of these decisions.

The family participant should regularly look at the production activities on the land. The decedent or family member should also advance funds and take on financial responsibility for a substantial part of the expense involved in the operation of the farm or other business in which the real property is used. An important factor in material participation in the case of a farm, is whether the owner or other family members furnish a substantial part of the machinery, implements, and livestock used in the production activities.

A factor in material participation when the trade or business is a farm, hotel, or apartment building is whether the participating decedent or heir maintains his or her principal place of residence on the premises. Material participation by the decedent or family members may ex-

ist even when a professional farm manager is used. However, the decedent or family member must materially participate under the terms of arrangement with the professional farm manager to satisfy this requirement.

Special rules for corporations, partnerships, and trusts. If property is indirectly owned, an arrangement must exist calling for material participation in the business by the decedent owner or a family member. In addition, full-time involvement must be under an arrangement between the entity and the decedent or family member specifying the services to be performed. Holding an office in which certain material functions are performed may constitute the necessary arrangement for material participation.

If the property is owned by a trust, the arrangement will generally be found in one or more of the following situations.

1) The arrangement may result from appointment as a trustee.
2) The arrangement may result from an employer-employee relationship in which the participant is employed by a qualified closely held business owned by the trust in a position requiring material participation in its activities.
3) The arrangement may result because the participants enter into a contract with the trustees to manage or take part in managing the real property for the trust.
4) If the trust agreement expressly grants the management rights to the beneficial owner, the grant is sufficient to constitute the required arrangement.

The same participation standards apply for property that is owned by a qualified closely held business as for property that is directly owned. In the case of a corporation, partnership, or trust in which the decedent or family members are employees and thus not subject to self-employment tax, they are viewed as if they were self-employed. Their activities must be of the nature that would subject them to self-employment taxes. When the property is owned by a corporation, partnership, or trust, participation in the management and operation of the real property itself as a component of a closely held business is the determinative factor. If a person nominally holds a position as a corporate officer or director and receives a salary or is merely listed as a partner and shares in the profits and losses, that alone does not support a finding of material participation. This applies even if the partner pays self-employment taxes on the distributive share of partnership earnings. Further, it applies for corporate directors in states where the board of directors does not need to be an active functioning entity or needs to act only informally. However, corporate offices held by an owner are factors considered in judging the degree of participation.

When real property is directly owned and leased to a corporation or partnership in which the decedent owns an interest that qualifies as an interest in a trade or business, the presence of material participation is determined by looking at the activities the participant takes part in with regard to the property. During any periods when qualified real property is held by an estate, material participation is to be determined as if the property were owned by a trust.

Active management. The active management of a farm or other business by an eligible qualified heir, or a fiduciary of certain eligible qualified heirs, is treated as material participation by that eligible qualified heir in the operation of the farm or business. The term "active management" means the making of the management decisions of a business (other than the daily operating decisions). This is a finding of fact, and the requirements can be met even if the income from the farm or other business is not subject to self-employment tax.

Active management, for farming purposes, includes the inspection of growing crops, review and approval of annual crop plans before planting, approval of large expenditures in advance, and making a large number of management decisions. Typical management decisions are deciding what crops to plant, where and when to market crops and other business products, how to finance operations, and what capital expenditures to make.

An ***eligible qualified heir*** is a qualified heir (discussed earlier) who is:

1) The surviving spouse, or
2) Under age 21, or
3) Disabled, or
4) A student.

An eligible qualified heir under requirement (2), (3), or (4) will be considered to materially participate by engaging in active management only during the period that he or she meets those requirements.

Active management by a fiduciary of an eligible qualified heir will be treated as material participation only if the heir is under 21 or disabled.

After 1981. A ***surviving spouse*** who received qualified real property from a spouse who died is considered to have materially participated if the surviving spouse was engaged in the active management of the farm or other business. If the surviving spouse dies within 8 years of the first spouse's death, the period of material participation by the first spouse is added to the period of active management by the surviving spouse to determine if the surviving spouse's estate qualifies for special-use valuation.

The property must have been eligible for special-use valuation in the first spouse's estate. The surviving spouse's estate may elect special-use valuation even if that valuation was not used by the estate of the first spouse who died.

Special-Use Valuation Methods

The discussion that follows explains the methods an executor may elect for special-use valuations for qualified real property.

Method for valuing farm real property. Generally, the special-use value of property that is used for farming purposes is determined as follows.

1) Subtract the average annual state and local real estate taxes on actual tracts of comparable real property from the average annual gross cash rental for that same comparable property, and
2) Divide the result in (1) by the average annual effective interest rate charged on new federal land bank loans.

The computation of each average annual amount is based on the 5 most recent calendar years ending before the date of the decedent's death. The average annual effective interest rate to be used for estates of decedents who died in 1980, 1981, and 1982 are set forth later in this section.

This method is used unless the executor does not document the cash rental from comparable lands or elects to use the method discussed later for valuing a real property interest in a closely held business.

Gross cash rental. Generally, gross cash rental is the total amount of cash received in a calendar year for the use of actual tracts of comparable farm real property in the same locality as the property being specially valued. This amount is not reduced by the amount of any expenses or liabilities associated with the farm operation or the lease. (A definition of comparable property and rules for property on which buildings or other improvements are located and on farms including multiple property types are given later in this section.)

For this method, you may use only rentals from tracts of comparable farm property that are rented solely for an amount of cash that is not based on production. The rentals considered must result from an arm's-length transaction (defined later). You may not use as accurate measures of cash rental value any rentals received under leases that provide for payment only in cash if the lessor (or a member of the lessor's family who is other than a lessee) is involved in the management or operation of the farm and the involvement amounts to material participation. This applies whether the lessor's involvement is contemplated or actually occurs. In general, therefore, rentals for any property that qualifies for special-use valuation cannot be used to compute gross cash rentals because the total amount received by the lessor does not reflect the true cash rental value of the real property.

Identification. Under this special valuation method, the executor must identify to the Internal Revenue Service the actual comparable property and cash rentals from that property. If this is not done but the special-use valuation has been elected, all specially valued real property must be valued under the rules discussed later for valuing property in a closely held business.

Arm's-length transaction. Under this method only cash rentals from a lease entered into in an arm's-length transaction are acceptable. For these purposes, arm's-length transactions do not include lands leased from the federal government or any state or local government for less than the amount that would be demanded by a private individual leasing for profit. They also do not include leases between family members, as defined earlier, that do not provide a return on the property to the same extent as that received under leases between unrelated parties in the locality.

Rents paid in kind and appraisals. Under this method, you may not use rents that are paid wholly or partly in kind (such as crop shares) to determine the value of real property. You also may not use appraisals or other statements regarding rental value or areawide averages of rentals (such as those compiled by the U.S. Department of Agriculture), because they are not true measures of the actual cash rental value of comparable property in the same locality as the specially valued property.

Five-year period. Comparable real property rented solely for cash must be identified for each of the 5 calendar years preceding the year of the decedent's death. Rentals from the same tract of comparable property need not be used for each of these 5 years, however, if an actual tract of property meeting the requirements for this method is identified for each year.

Rents that include use of equipment. In general, no adjustment to the rents actually received by the lessor is made for the use of any farm equipment or other personal property when its use is included under a lease for comparable real property. However, an adjustment is made if the lease specifies the amount of the total rental attributable to the personal property.

State and local real estate taxes. For purposes of the farm valuation formula, state and local taxes are taxes that are assessed by a state or local government and that are allowable as itemized deductions. However, you may use in the valuation formula only those taxes on the comparable real property from which cash rentals are determined.

Comparable real property. Comparable real property must be situated in the same locality as the specially valued property. This is not solely a matter of mileage or political division. Instead, it is determined according to generally accepted real property valuation rules.

The determination of properties that are comparable is a factual one. It is based on numerous factors, no one of which is determinative. It is often necessary therefore, to value farm property in segments where there are different uses or land characteristics included in the specially valued farm. For example, rental property on which comparable buildings or improvements are located must be identified for specially valued property on which buildings or other real property improvements are located. In cases of multiple uses or land characteristics, actual comparable property for each segment must be used, and the rentals and taxes from all the properties must be combined. However, any premium or discount resulting from the presence of multiple uses or other characteristics in one farm also is reflected.

All factors generally considered in real estate valuation are considered in determining comparability. The following list contains some of the factors considered in determining comparability:

1) Similarity of soil as determined by any objective means, including an official soil survey reflected in a soil productivity index,
2) Whether the crops grown would deplete the soil in a similar manner,
3) Types of soil conservation techniques that have been practiced on the two properties,
4) Whether the two properties are subject to flooding,
5) Slope of the land,
6) For livestock operations, the carrying capacity of the land,
7) For timbered land, whether the timber is comparable to that on the subject property,
8) Whether the property as a whole is unified or segmented; if segmented, the availability of the means necessary for movement among the different sections,
9) Number, types, and conditions of all buildings and other fixed improvements located on the properties and their location as it affects efficient management, use, and value of the property, and
10) Availability and type of transportation facilities in terms of costs and of proximity of the properties to local markets.

Effective interest rate. Generally, the annual effective interest rate on new federal land bank loans is the average billing rate charged as adjusted on new agricultural loans to farmers and ranchers in the district in which the real property to be valued is located.

Use the following table to determine what district the property is located in.

District	States
Baltimore	Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, West Virginia.
Columbia	Florida, Georgia, North Carolina, South Carolina.
Houston	Texas.
Louisville	Indiana, Kentucky, Ohio, Tennessee.
New Orleans	Alabama, Louisiana, Mississippi.
Omaha	Iowa, Nebraska, South Dakota, Wyoming.
Sacramento	Arizona, California, Hawaii, Nevada, Utah.
St. Louis	Arkansas, Illinois, Missouri.
St. Paul	Michigan, Minnesota, North Dakota, Wisconsin.
Spokane	Alaska, Idaho, Montana, Oregon, Washington.
Springfield	Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, Vermont.
Wichita	Colorado, Kansas, New Mexico, Oklahoma.

Use the following table to find the average annual effective interest rate for the year of death.

District in which property is located	Year of Death		
	1980	1981	1982
Baltimore	9.24%	9.66%	10.48%
Columbia	9.17%	9.40%	9.81%
Houston	8.76%	9.09%	9.74%
Louisville	9.21%	9.53%	10.02%
New Orleans	8.96%	9.33%	9.88%
Omaha	9.25%	9.59%	10.17%
Sacramento	9.35%	9.63%	10.12%
St. Louis	9.20%	9.77%	10.37%
St. Paul	8.95%	9.30%	9.84%
Spokane	9.31%	9.60%	10.13%
Springfield	8.81%	9.10%	9.52%
Wichita	9.08%	9.56%	10.26%

After 1981. For the estate of a person who dies after 1981, you may be able to use the ***average annual net share rental*** from comparable land instead of the average annual gross cash rental to determine the special-use value of the farm land. You also may elect to exclude trees growing on ***qualified woodlands*** from being treated as a crop. This means the trees will then qualify for special-use valuation.

Net share rental. You may use the average annual net share rental from comparable land only if there is no comparable land from which average annual gross cash rental can be determined. If there are cash rentals from comparable land, you must use the cash rental method. The requirements in the earlier discussion on the cash rental method apply to the share rental method.

For this purpose, net share rental means the gross value of the produce received by the lessor of the comparable land on which the produce grows minus the cash operating expenses (other than real estate taxes) of growing the produce that, under the lease, are paid by the lessor.

The term ***produce*** means crops or other products, such as cattle. The production of the produce must be the business purpose of the farming operation.

The ***gross value of the produce*** is generally the gross amount received in the disposition of the produce if it is disposed of in an arm's-length transaction within the period established by the Department of Agriculture for its price support program. This is currently the 5-month period immediately after the date the lessor received (or constructively received) the produce. If there is no arm's-length transaction within this period, the value will be the weighted average price for which the produce sold on the national or regional commodities market closest to the farm property. The price will be determined as of the date the lessor received (or constructively received) the produce. If the lessor received only the proceeds (or an agreed set value) of his or her part of the farm's production, the share rental is determined under these rules as if the lessor had received his or her share of the produce.

Qualified woodlands. You may elect to treat trees (standing timber) growing on a qualified woodland as an interest in real property rather than as a crop. Therefore, you may specially value the timber as part of the qualified real property on which it is located. The election is made on the estate tax return and cannot be changed.

A "qualified woodland" is any real property that is used in timber operations and that is an identifiable area of land. The term ***timber operations*** means planting, cultivating, caring for, or cutting trees, or preparing (other than milling) trees for market. An identifiable area is an acre or other area of land for which records are normally maintained for the timber operation.

You may use the cash rental method or if there is no comparable land to determine the cash rental, the share rental method to value the timber. The rentals must be on similar timber located on comparable land on which both the timber and land are rented for timber growing purposes. Other leases on the comparable property are not used in determining the value of qualified woodlands. If there are no comparable rentals on land and timber in the locality of the property to be valued, use the method for valuing a closely held business to determine the value of the timber and land.

To make the election, you must attach to the estate tax return a statement that:

1) Contains the decedent's name and taxpayer identification number as they appear on the estate tax return,
2) Identifies the election as a section 2032A(e)(13) election,
3) Specifies the property for which the election is made, and
4) Provides all information necessary to show that you are entitled to make the election.

If the Internal Revenue Service later asks you to furnish additional information, furnish it to the office making the request within 60 days after it is requested. The statement containing the requested information should also contain the information in (1), (2), and (3) above. If you do not provide the additional information within 60 days after it is requested, the election may be held invalid.

Method of valuing a real property interest in a closely held business. This method is used to determine the special-use valuation for qualifying real property used in a trade or business other than farming. You may also use this method for qualifying farm property if there is no comparable land from which cash rentals or share rentals can be determined, or if you elect to use this method for farm property. Under this method, the value of real property is determined by applying the following factors:

1) The capitalization of income that the property can be expected to yield for farming or for closely held business purposes over a reasonable period of time with prudent management and traditional cropping patterns for the area, taking into account soil capacity, terrain configuration, and similar factors.
2) The capitalization of the fair rental value of the land for farming or for closely held business purposes.
3) The assessed land values in a state that provides a differential or use value assessment law for farmland or closely held business.
4) Comparable sales of other farm or closely held business land in the same geographical area far enough removed from a metropolitan or resort area so that nonagricultural use is not a significant factor in the sales price.
5) Any other factor that fairly values the farm or closely held business value of the property.

Dispositions and Failures to Use for Qualified Use

Some or all of the estate tax benefits obtained through reduced valuation may be recaptured under some circumstances. For the estate of a decedent who died before 1982, this would happen if within 15 years after the death of the decedent but before the death of the qualified heir, the qualified heir disposes of the property to nonfamily members or the property ceases to be used for farming or other closely held business purposes.

The amount of the tax benefit potentially subject to recapture (additional estate tax) is the lesser of the following:

1) The excess of the estate tax liability that would have been incurred if the special-use valuation had not been used ***over*** the estate tax liability based on the special-use valuation, or
2) The excess of the amount realized on the property (or the fair market value of the property in any case other than a sale or exchange at arm's length) ***over*** the value of the property determined under this method of valuation.

After 1981. The 15–year recapture period has been changed for the estate of a decedent who dies after 1981. For these estates, the recapture period is 10 years.

Liability for additional estate tax. If any additional estate tax is due, the qualified heir must file Form 706–A, *United States Additional Estate Tax Return*, within 6 months after the taxable disposition or the end of the qualified use, unless the Service has granted an extension of time. Interest on the additional estate tax will be assessed only for the period from the due date (6 months after the disposition or the end of qualified use) until the tax is paid.

A qualified heir is personally liable for the additional estate tax to the extent of the heir's interest in the qualified real property. However, the heir will not be liable if a bond is furnished that meets certain requirements.

Bond requirements. A qualified heir may apply in writing to the Internal Revenue Service for a determination of the maximum additional estate tax that may be imposed on the heir's interest in the qualified real property. The Service will notify the heir as soon as possible of the maximum amount of the tax liability. The Service will send the notice within one year of the date the application is made.

By furnishing a bond for the maximum amount of the tax and for the period required, the heir will be discharged from personal liability. The qualified heir is entitled to a receipt or writing that acknowledges the discharge from personal liability.

Involuntary conversions. If an involuntary conversion—such as a condemnation—of qualified real property takes place, the qualified heir may avoid additional estate tax liability. To do so, the heir must elect to replace the property by other real property of at least equal value that is used for the same qualified use. When involuntarily converted property is only partially replaced, determine the additional estate tax liability by reducing the amount of tax that would have been imposed by an amount that bears the same ratio to the tax as the cost of the qualified replacement property bears to the amount realized on the conversion. Any additional estate tax that is imposed on the involuntary conversion is treated as a tax imposed on a partial disposition.

To make ***the election,*** notify the Internal Revenue Service by sending a letter to the office where the decedent's Form 706 was filed. The letter should include a statement of election of such treatment, a description of both the converted property and the replacement property, the amount realized, and the cost of the replacement property.

If the involuntarily converted property is only partially replaced, make the election on Form 706–A, which is used to compute the additional estate tax liability.

In determining the imposition of and the amount of the additional estate tax (and the special lien, described later), any qualified replacement property must be treated just as if it were a portion of the interest in the qualified real property that was involuntarily converted. However, the 10– or 15–year period described earlier is extended by any period during which the qualified heir was allowed to replace the qualified real property. However, this extension does not include the 2–year period generally allowed for replacement of involuntarily converted property.

In determining whether property has ceased to be used for a qualified use, do not consider periods after the involuntary conversion and before the acquisition of the qualified replacement property. Material participation with respect to the converted property is treated as material participation with respect to the qualified replacement property.

After 1981. If the involuntary conversion takes place after 1981, no election has to be made. The additional estate tax will apply only if the cost of the qualified replacement property is less than the amount realized on the conversion. You must notify the Service of the conversion.

Like-kind exchanges. The additional estate tax does not apply to a like-kind exchange made after 1981. This is an exchange of an interest in qualified real property solely for an interest in qualified exchange property. However, the tax will apply if other property is also received in the exchange. The full additional estate tax on the interest exchanged is reduced by a percentage. Determine the percentage by dividing the fair market value of the other property by the fair market value of the qualified real property exchanged. Fair market value is determined at the time of the exchange. Any tax on the exchange is treated as a tax on a partial disposition.

The term ***qualified exchange property*** means real property that will be used for the same qualified use as was applied to the property for which it was exchanged. Any interest in qualified exchange property is treated just as if it were an interest in the qualified real property that was exchanged. Material participation with respect to the exchanged property is treated as material participation with respect to the qualified exchange property.

Disposition of timber. If the election had been made to treat standing timber as an interest in real property (discussed earlier), a disposition of part of that interest in qualified real property occurs if a qualified heir severs or otherwise disposes of the standing timber on the qualified woodland during the recapture period. The disposition of a right to sever is treated as a disposition of the standing timber.

The additional estate tax on this disposition is the amount equal to the lesser of:

1) The amount realized on the disposition (or, if other than a sale or exchange at arm's length, the fair market value of the part of the interest disposed of), or
2) The amount of additional estate tax that would have been imposed if the entire interest of the qualified heir in the qualified woodland had been disposed of, minus any additional estate tax imposed on all earlier transactions involving that woodland.

Property ceases to be used for a qualified use if it is no longer used as a farm or in a closely held business. It also ceases if no material participation exists for periods of time totaling more than 3 years in any 8–year period that ends after the decedent's death but before the death of the qualified heir. Generally, if the qualified heir dies without having disposed of the property but having retained its qualified use, the potential liability for the additional estate tax ceases.

The additional estate tax does not apply to the failure by the qualified heir to use the property before the commencement date. The commencement date is the date on which the heir begins to use the qualified real property. However, for this exception, the commencement date must be within 2 years after the decedent's death. If the commencement date is within 2 years of the decedent's death, the 10– or 15–year period is extended by the period after the decedent's death and before the commencement date.

Phaseout of the additional estate tax. For the estate of a person who died before 1982, there is a phaseout of the additional estate tax liability if the disposition or failure to use occurs more than 10 years after the decedent's death. The additional tax imposed is reduced by an amount determined by multiplying the additional tax by the following fraction: the numerator is the number of full months after the date of death of the decedent in excess of 120, and the denominator is 60.

The liability for additional tax is completely eliminated 15 years following the decedent's death.

After 1981. For the estate of a person who died after 1981, there is no phaseout period because the 15–year period has been changed to a 10–year period. Therefore, any disposition or failure to use that occurs after the 10–year period will not be subject to the additional estate tax.

Lien. A special lien in favor of the United States attaches to the property for which an election to use the special-use valuation has been made. The lien equals the adjusted tax difference attributable to the interest in the property. In an involuntary conversion, the lien attaches to the qualified replacement property and in a like-kind exchange it attaches to the qualified exchange property. The lien continues until:

1) The liability for the additional tax has been satisfied, or
2) The liability has become unenforceable because of the lapse of time, or
3) It is established to the satisfaction of the Internal Revenue Service that no further tax liability may arise.

Security may be furnished to substitute for this lien. The Secretary of the Treasury may also issue a certificate of subordination of this special lien if it is determined that the interests of the United States are protected adequately after the subordination.

Election of Special Valuation

You make the election to use the special-use valuation on the estate tax return. Check the box as indicated on the return, and attach the agreement and notice of election as described later. Once made, the election cannot be changed. For the estate of a decedent who died before 1982, the election must be made on a timely filed return.

After 1981. For the estate of a person who died after 1981, the election must be made on the first estate tax return filed by the estate. The return does not have to be filed on time for the election to apply.

Elections for less than all qualified real property. An election need not include all real property included in an estate that is eligible for special-use valuation. However, at least 25% of the adjusted value of the gross estate must be specially valued under the election. For example, some acreage contained in a farm may be valued at its fair market value if the heirs plan to sell that land, while other acreage may be valued at its special-use value.

If qualified heirs receive joint or undivided interests (for example, interests as joint tenants or tenants in common) in the same property, an election for one heir's joint or undivided interest does not have to include any other heir's interest in the same property. However, the electing heir's interest plus other property to be specially valued must satisfy the 25% requirement mentioned above. If a decedent creates successive interests (for example, life estates and remainder interests) in otherwise qualified property, the election is available only for that property (or portion of property) in which qualified heirs of the decedent receive all the successive interests. The election must include the interests of all of those heirs. For example, if a surviving spouse receives a life estate in otherwise qualified property and the spouse's brother receives a remainder interest in fee, no part of the property may be valued under the special-use valuation. This would also apply if the remainder interest was transferred to a charity.

When successive interests in specially valued property are created, remainder interests may be treated as being received by qualified heirs. They are treated in this way only if the remainder interests are not contingent upon surviving a nonfamily member or are not subject to divestment in favor of a nonfamily member.

Agreement to special-use valuation. Generally, an agreement must be executed by all parties who have any interest in the property being valued based on its qualified use as of the date of death. For a qualified heir, the agreement must express consent to personal liability for additional estate tax in the event of certain early dispositions of the property or early cessation of the qualified use. For parties other than qualified heirs with interests in the property, the agreement must express consent to collection of any additional estate tax imposed.

The agreement must be in a form that is binding on all parties having an interest in the property. It must give the name and address of an agent with satisfactory evidence of authority to act for the parties to the agreement in all dealings with the Internal Revenue Service on matters arising under the agreement to the special valuation.

The Internal Revenue Service will contact the designated agent on all matters relating to continued qualification of the specially valued real property and on all matters relating to the special lien. The agent is the attorney-in-fact for the parties with interests in the specially valued real property and must furnish the Service with any requested information. The agent must also notify the Service of any disposition or cessation of qualified use of any part of the property.

An ***interest in property*** is an interest that, as of the date of the decedent's death, can be asserted under local law so as to affect the disposition of the specially valued property by the estate. Any person in being at the death of the decedent who has any interest in the property, whether present or future, or vested or contingent, must enter into the agreement. Examples of holders of an interest in property are: owners of remainder and executory interests; holders of general or special powers of appointment; beneficiaries of a gift over in default of exercise of any power; co-tenants; joint tenants and holders of other undivided interests when the decedent held only a joint or undivided interest in the property or when only an undivided interest is specially valued; and trustees of trusts holding any interest in the property.

Persons who are not considered to have an interest in property include an heir who has the power under local law to challenge (caveat) a will and thus affect disposition of the property or an estate's creditors merely because of their status as creditors.

In some cases a representative may sign the agreement for the person with an interest in property. The representative must be authorized under local law to bind the person in such an agreement. The person with the interest must want the representative to act for him or her or must be unable to enter a binding agreement because he or she is too young, is incompetent, or dies before the election is exercised. Proof of the power to act must be attached to the agreement.

A sample form of the agreement to special valuation follows.

AGREEMENT TO SPECIAL VALUATION UNDER SECTION 2032A

Estate of _____

Date of Death: _____

Decedent's Social Security Number: _____

We, _____, _____, _____, being all of the qualified heirs and, _____, _____, _____, _____, other parties having interests in the property which is qualified real property and which is valued under section 2032A of the Internal Revenue Code, do hereby approve of the election being made by _____, Executor/Administrator of the Estate of _____, pursuant to section 2032A, to value said property on the basis of the qualified use to which the property is devoted and do hereby enter into this agreement pursuant to section 2032A(d).

The undersigned agree and consent to the application of subsection (c) of section 2032A of the Code with respect to the following described property:

[Complete legal description of property]

More specifically, the undersigned qualified heirs expressly agree and consent to personal liability under subsection (c) of 2032A for the additional tax imposed by that subsection with respect to their respective interests in the above-described property in the event of certain early dispositions of the property or early cessation of the qualified use of the property. It is understood that if a qualified heir disposes of any interest in qualified real property to any member of his or her family, such member shall thereafter be treated as the qualified heir with respect to such interest.

The undersigned interested parties who are not qualified heirs consent to the collection of any additional estate tax imposed under section 2032A(c) of the Code from the specially valued property.

If there is a disposition (other than to a member of his or her family) of any interest which passes or has passed to him or her or if there is a cessation of the qualified use of any specially valued property which passes or passed to him or her, each of the undersigned heirs agrees to file a Form 706-A, United States Additional Estate Tax Return, and pay any additional estate tax due within six months of the disposition or cessation.

It is understood by all interested parties that this agreement is a condition precedent to the election of special-use valuation under section 2032A of the Code and must be executed by every interested party even though that person may not have received the estate tax benefits or be in possession of such property.

Each of the undersigned understands that by making this election, a lien will be created and recorded pursuant to section 6324B of the Code on the property referred to in this agreement for the adjusted tax difference with respect to the estate as defined in section 2032A(c)(2)(C).

As the interested parties, the undersigned designate the following individual as their agent for all dealings with the Service concerning the continued qualification of the specially valued property under section 2032A of the Code and on all issues regarding the special lien under section 6324B. The agent is authorized to act for the parties with respect to all dealings with the Internal Revenue Service on matters affecting the qualified real property described earlier. This authority includes the following:

To receive confidential information on all matters relating to continued qualification under section 2032A of the specially valued real property and on all matters relating to the special lien arising under section 6324B.

To furnish the Service with any requested information concerning the property.

To notify the Service of any disposition or cesstion of qualified use of any part of the property.

To receive, but not to endorse and collect, checks in payment of any refund of Internal Revenue taxes, penalties, or interest.

To execute waivers (including offers of waivers) of restrictions on assessment or collection of deficiencies in tax and waivers of notice of disallowance of a claim for credit or refund.

To execute closing agreements under section 7121.

Other acts (specify) _____

By signing this agreement, the agent agrees to provide the Service with any requested information concerning this property and to notify the Service of any disposition or cessation of the qualified use of any part of the property.

Name of Agent Signature Address

The property to which this agreement relates is listed in Form 706, United States Estate Tax Return, and in the notice of election pursuant to section 20.2032A-8(a)(3) of the Estate Tax Regulations, along with its fair market value according to section 2031 of the Code and its special-use value according to section 2032A. The name, address, social security number, and interest (including the value) of each of the undersigned in this property are as set forth below:

Name	Address	Soc. Sec.	Interest and Fair Market Value of Interest

IN WITNESS WHEREOF, the undersigned have hereunto set their hands at _____, this _____ day of _____.

Qualified Heirs Other Interested Parties

Notice of election. The notice must contain the following information:

1) The decedent's name and taxpayer identification number as they appear on the estate tax return,
2) The relevant qualified use,
3) The items of real property shown on the estate tax return to be specially valued under the election (identified by schedule and item number),
4) The fair market value of the property to be specially valued and the property's value based on its qualified use (both values determined without reduction for unpaid mortgages, etc.),
5) The adjusted value of all real property (after reduction for unpaid mortgages, etc.) that is used in a qualified use and that passes to a qualified heir, and the adjusted value of all real property to be specially valued,
6) The items of personal property shown on the estate tax return that pass from a decedent to a qualified heir and that are used in a qualified use (identified by schedule and item number), and the total value of the personal property (reduced by unpaid mortgages, etc.),
7) The adjusted value of the gross estate (gross estate minus any unpaid mortgages, etc.),
8) The method used for determining the special value based on use,
9) Copies of written appraisals of the fair market value of the real property,
10) A statement that the decedent or a member of his or her family has owned all specially valued real property for at least 5 years immediately preceding the date of the decedent's death,
11) Any periods during the 8 years preceding the date of the decedent's death during which the decedent or a member of his or her family did not own the property, use it in a qualified use, or materially participate in the operation of the farm or other business,
12) The name, address, taxpayer identification number, and relationship to the decedent of each person taking an interest in each item of specially valued property, and the value of the property interests passing to each person based on both fair market value and qualified use,
13) Affidavits describing the activities constituting material participation and the identity of the material participant or participants, and
14) A legal description of the specially valued property.

Protective election. The estate may be able to make a protective election to specially value qualified real property. The availability of special-use valuation under this protective election depends upon the values finally determined (or agreed to following examination of a return) that meet the requirements of the special-use election. A protective election does not extend the time for payment of any tax.

To make the protective election file a notice of election with a timely estate tax return stating that you are making a protective election for special-use valuation pending final determination of values. Include the following information in the notice:

1) The decedent's name and taxpayer identification number as they appear on the estate tax return,
2) The relevant qualified use, and
3) The items of real and personal property shown on the estate tax return that are used in a qualified use, and that pass to qualified heirs (identified by schedule and item number).

If the estate qualifies for special-use valuation based upon values as finally determined or agreed to, the estate must file an additional notice of election within 60 days after the date of the determination. This notice must contain the information required for an actual election (discussed earlier). Attach it and the agreement to special-use valuation (discussed earlier) to an amended estate tax return. The amended return is to be filed with the Service office where the original return was filed.

Taxable Estate

The ***taxable estate*** is the gross estate minus:

1) Administration and funeral expenses,
2) Claims against the estate,
3) Any outstanding obligation to which the property is subject, if the value is included in the gross estate and is undiminished by the outstanding indebtedness,
4) Casualty and theft losses,
5) Orphans' deduction,
6) Marital deduction, and
7) Charitable deduction.

Administration Expenses, Funeral Expenses, Claims, and Obligations

A deduction is allowed for amounts payable out of ***property subject to claims*** (generally, the probate assets) for:

1) Funeral expenses,
2) Administration expenses incurred in administering property subject to claims,
3) Claims against the estate, and
4) Unpaid mortgages and other charges (indebtedness) against property if the value of the property is included in the gross estate without reduction for the mortgage or other indebtedness. This deduction includes the interest accrued to the date of decedent's death.

Limitation. The amount of the deduction is the amount paid for these expenses that is allowable under the local law governing the administration of the decedent's estate. The total deduction, however, is limited to:

1) The value of property subject to claims included in the decedent's gross estate, ***plus***
2) The amount paid out of property included in the gross estate but not subject to claims. This amount must actually be paid within the time allowed for the filing of the estate tax return.

The applicable local law under which the estate is being administered determines which property is subject to claims and which property is not subject to claims. If under local law a particular property interest included in the decedent's gross estate would bear the burden for the payment of the expenses, then the property is considered ***property subject to claims.*** For this purpose, the value of this property is reduced by the amount of any deduction allowed for a casualty or theft loss to the property during the settlement of the estate.

Example. The only items in the gross estate were a bank deposit of $20,000 and jointly owned real estate, valued at $250,000 at decedent's death. The bank account was subject to claims, but the real estate, under local law, was not. Funeral expenses amounted to $1,000 and the debts of the decedent totaled $29,000, both of which were allowable under local law.

If the executor paid the funeral expenses and $19,000 of the debts out of the bank account, the estate could claim $20,000 in deductions.

If, in addition, the surviving spouse paid the remaining $10,000 of debts ***before*** the executor filed the return, the estate could claim a $30,000 deduction.

If the surviving spouse paid the remaining $10,000 in debts ***after*** the time required to file the return, the estate could claim only $20,000 in deductions.

If, on the other hand, the executor paid only $5,000 out of the bank account for the funeral expenses and debts, and the surviving spouse paid $20,000 ***before*** filing the return and the remaining $5,000 ***after*** the time required to file, the estate would be entitled to the full $30,000 deduction. This is because the allowable deduction is the amount that is ***payable*** out of property subject to claims and is actually paid ($30,000) from any source in the gross estate, but limited to the value of:

1) The property subject to claims ($20,000), ***plus***
2) The amount actually paid out of property not subject to claims before the return is filed ($20,000).

Since the amount actually paid ($30,000) is within the limitation ($40,000), the full $30,000 may be deducted.

Property not subject to claims. A deduction is also allowed for the expense of administering property that is not subject to claims (generally, nonprobate assets included in the gross estate), if:

1) The expense is paid before the expiration of the period of limitation for assessing the federal estate tax (generally, 3 years after filing), and
2) The expense is allowable by the law governing the administration of the decedent's estate as if the property were subject to claims.

Estimated amount. If at the time of filing the estate tax return, the exact amount of a deductible item is not known, you may enter an estimated amount for that item on the return if you can determine the estimated amount with reasonable certainty and can show that the item will be paid.

Administration Expenses

These expenses include your commissions as the executor, fees of attorneys for the estate, and miscellaneous expenses.

Expenditures not essential to the proper settlement of the estate, but incurred for the individual benefit of beneficiaries (heirs, legatees, or devisees) are not deductible. An attorney's fee incurred by a beneficiary that is not essential to the proper settlement of the estate is not deductible as an administration expense, even if it is approved by a probate court as an expense payable or reimbursable by the estate.

If the estate includes property located in a foreign country and if administration expenses are incurred on that property, you must determine the United States dollar value for those expenses. For this purpose, use the foreign exchange rate in effect on the date you make the payment.

Miscellaneous expenses. These expenses include court costs, accountants' fees, appraisers' fees, and other expenses necessary for preserving and distributing the estate. They include the cost of storing or maintaining property of the estate for a reasonable period of time before the property is distributed. They do not include the cost of additions or improvements to the property. Excise taxes incurred in distributing property in kind are deductible administration expenses.

Selling expenses. If property has to be sold to pay the decedent's debts, administration expenses, or taxes or to maintain the estate or make a distribution, the expenses of the sale are deductible. These expenses include brokerage fees, excise taxes on the sale, and other expenses of the sale.

Interest expenses. Interest expenses incurred after the decedent's death are generally allowed as a deduction if they are reasonable and necessary to the administration of the estate. The interest must be allowable under local law.

The interest that accrues after death on federal and state ***income tax*** deficiencies while an executor contests the imposition of the taxes is deductible as an administration expense.

Interest payable on a loan incurred to pay ***estate taxes*** is deductible as an administration expense.

Interest incurred as the result of a federal ***estate tax or gift tax*** deficiency is a deductible administration expense.

If you elect ***installment payments*** for the estate tax, you may deduct the interest payable on those installments. You may not deduct an estimate of the amount of interest payable, because you may have to accelerate the payment of the tax. Therefore, this interest expense is deductible only when the interest accrues. (Installment payments are discussed earlier under *The Estate Tax Return.*)

Interest incurred as the result of a ***late payment*** of the federal estate tax or a state death tax is deductible as an administration expense. However, any ***penalty*** for failure to pay or failure to file is not deductible as an administration expense even if it is allowable under local law.

Interest accrued on obligation of decedent. An administration expense is not allowed for interest that is payable after a decedent's death and that is attributable to an installment obligation incurred by the decedent. If the decedent had lived, he or she would have been liable for the interest as well as the principal. Since the interest is not actually and necessarily incurred in the administration of the decedent's estate, it is not allowable as an administration expense.

Funeral Expenses

These expenses are allowed as a deduction from the gross estate if they are actually paid, are allowable out of property subject to claims under local law, and satisfy the limitation (discussed earlier) for the total amount of expenses allowed for the items discussed in this section. Deductible expenses may include the cost of a tombstone, monument, mausoleum, or a burial lot, either for the decedent or the decedent's family, and a reasonable expenditure for its future care if allowable by the local law. The cost of transportation of the person bringing the body to the place of burial is deductible.

The estate is allowed a deduction if it is primarily liable under local law for the decedent's funeral expenses and last illness expenses. (Last illness expenses are deductible as a claim against the estate.) However, under local law, the husband may be primarily liable for the funeral and last illness expenses of his deceased wife. In this case, the estate would be allowed a deduction for these expenses only if the wife's will directs that these expenses be paid out of her estate.

Claims Against the Estate

Amounts that may be deducted as claims against a decedent's estate are only for enforceable personal obligations of the decedent at the time of death and interest on those obligation that had accrued at the time of death. It does not matter whether the obligations had matured. Only interest accrued up to the date of death is deductible even though the executor elects the alternate valuation date.

Medical expenses of the decedent are deductible as a claim against the estate. (See *Medical expenses,* later.) Deductions for claims founded upon promises or agreements are limited to the extent that the liabilities were contracted in good faith and for adequate and full consideration in money or money's worth. However, a pledge or subscription in favor of a public, charitable, religious, or educational organization is deductible to the extent that it would have constituted an allowable deduction if it had been a bequest. (See *Charitable Deduction,* later.)

If the estate has to pay a claim in a foreign currency, you must determine the United States dollar value for that claim. For this purpose, use the foreign exchange rate in effect on the date of death (or alternate valuation date). However, if events that occur after death must be considered in valuing the claim, you must use the foreign exchange rate in effect on the date of payment.

Taxes. Taxes that are deductible as claims against the estate include property taxes accrued before the decedent's death, unpaid income taxes on income received by the decedent during life, and unpaid gift taxes on gifts made by the decedent during life. Unpaid state gift taxes are deductible even if, when they are paid, they are credited against a state inheritance tax.

Taxes that are not deductible include income taxes on income received after the decedent's death, property taxes not enforceable before death, or any estate, succession, legacy, or inheritance taxes.

State or foreign death tax deduction. If a state or a foreign country imposes a death tax on a transfer made by a decedent for charitable purposes, the estate may elect to take a deduction for the payment of this tax rather than the state or foreign death tax credit. The deduction is allowed only if the decrease in the federal estate tax because of the deduction benefits only the charity, or if the federal estate tax is apportioned among all beneficiaries of property included in the estate. When the deduction is claimed, the credit for state death taxes or foreign death taxes, whichever is applicable, is reduced to reflect that a portion of the tax is used as a deduction rather than as a credit. These credits are discussed later.

Other Indebtedness

This includes any unpaid mortgages and other indebtedness against property included in the estate. It also includes any interest that had accrued on these obligations to the date of the decedent's death.

If the estate is liable for the payment of the obligation, you must include the full value of the property in the gross estate and deduct the amount of the outstanding indebtedness.

If the estate is not liable for the obligation, include only the value of the property minus the obligation in the gross estate.

However, if a decedent who died before 1982 gave real property within 3 years of death, and the donee (recipient) mortgaged the property, the value of the property that is included in the decedent's gross estate is not reduced by the amount of the mortgage. This is because the mortgage did not benefit the decedent.

If the mortgage is on jointly held property, only that part of the mortgage for which the decedent was liable and for which the estate must pay is deductible.

Insurance proceeds paid to divorced spouse. Generally, the decedent's estate includes life insurance proceeds paid directly to a divorced spouse if under the divorce decree the decedent was required to name the former spouse as beneficiary of a life insurance policy and was obligated to keep the policies in force until the

former spouse's death or remarriage (at which time the proceeds become payable to the decedent or the decedent's estate). (See the earlier discussion under *Proceeds of Life Insurance.*)

The payment of the insurance proceeds to the former spouse satisfies an indebtedness created in settlement of the decedent's marital obligations.

Thus, since the insurance proceeds are includible in the decedent's gross estate at full value (because of a reversionary interest in the proceeds), the obligation to pay the decedent's former spouse is an indebtedness against property included in the gross estate. Therefore, the proceeds of the life insurance policy may be deducted from the gross estate of the decedent.

Income Tax vs. Estate Tax Deduction

You may not use amounts allowable as administration expenses or losses (discussed later) during administration of the estate as deductions in computing the taxable income of the estate for income tax purposes unless you waive the deduction for estate tax purposes. The total deductions, or the total amount of any deduction, does not have to be treated in the same way. One deduction, or a portion of a deduction, may be allowed for income tax purposes if the waiver is filed and another deduction or portion may be allowed for estate tax purposes.

File the waiver with the income tax return in the year the expenses are claimed on the return for income tax purposes. This waiver is irrevocable.

Taxes, interest, and business expenses accrued at the date of the decedent's death are deductible as claims against the estate on the estate tax return and also as deductions in respect of the decedent on the income tax return of the estate or a beneficiary who received the property subject to these expenses. If these expenses were not accrued at the date of the decedent's death, they are administration expenses and are deductible only on the estate tax return unless you file the waiver. See Publication 559, *Tax Information for Survivors, Executors, and Administrators*, for a discussion of income and deductions in respect of a decedent.

Funeral expenses are allowable only as deductions in computing the estate tax.

Medical expenses. If medical expenses are deducted only on the estate tax return, they are fully deductible as claims against the estate.

If expenses for the decedent's medical care are paid within one year after date of death, they are treated as being paid in the tax year in which they were incurred. In this case, if a waiver is filed the expenses may be deducted on the decedent's income tax return for the year incurred. The deduction may be claimed only to the extent that the decedent's total medical deduction for that year exceeds 3% of the decedent's adjusted gross income.

If part of the medical expenses are deducted on the decedent's income tax return and part deducted on the estate tax return, the part deducted on the estate tax return may not include the amount equal to 3% of the decedent's adjusted gross income that is not deductible for income tax purposes.

Example. The decedent incurred $20,000 in medical expenses during the 6-month period before death. These were the only medical expenses incurred during the year. The decedent's final income tax return showed an adjusted gross income of $100,000.

You, as the executor of the decedent's estate, paid the $20,000 in medical expenses within one year of the decedent's death. You elected to deduct $5,000 as a claim against the estate and filed the necessary waiver indicating that $15,000 had not been and would not be deducted for estate tax purposes. Therefore, only $12,000 ($15,000 − $3,000 (3% × $100,000)) is deductible on the decedent's final income tax return.

If you had deducted all the medical expenses as claims against the estate, $20,000 would be deductible for estate tax purposes.

Selling expenses. These expenses cannot be used to offset the sales price of property in determining gain or loss if they have been deducted for estate tax purposes as an administration expense.

Alimony payments. The commuted value of alimony payments to be made by the estate is deductible as a claim against the estate if the court that issued the divorce decree had the power to settle all property rights. The alimony payments made by the fiduciary during administration are deductible for income tax purposes. If the court did not have jurisdiction to settle all property rights, the value of the alimony payments would be deductible only to the extent that they do not exceed the reasonable value of the support rights of the ex-spouse.

Form 706

If these deductions are used to determine the taxable estate, list them on the following schedules.

Funeral expenses and expenses incurred in administering property subject to claims are listed on Schedule J, Form 706.

Claims against the estate and other indebtedness (mortgages, etc.) are listed on Schedule K, Form 706.

Expenses incurred in administering property not subject to claims are listed on Schedule L, Form 706.

Casualty or Theft Losses

Deductions are allowed for losses incurred during the settlement of the estate arising from theft or casualties, such as storms or fires. But they are allowed only to the extent that the losses are not compensated for by insurance or in another manner. You may waive the right to claim a loss for estate tax purposes if you want to claim the loss in computing the taxable income of the estate for income tax purposes.

Form 706. The net losses allowable for estate tax purposes are listed on Schedule L, Form 706.

Orphans' Deduction

For the estate of a decedent who died after 1976 but before 1982, a deduction is allowed for transfers to a decedent's minor children who have no known surviving parent. The interest transferred must have been included in the gross estate.

A minor child is one who is less than 21 years old at the date of the decedent's death.

If a child's parents were divorced and the deceased parent is survived by the other known parent, the orphans' deduction will not be allowed. On the other hand, the deduction is allowed for a legally adopted minor child whose deceased adoptive parent is not survived by a spouse. This applies even if one or both of the natural parents of the child are known and surviving. But it does not apply if it can be shown that the adoption was motivated to obtain this deduction.

Limitation. This deduction may not be more than $5,000 multiplied by the number of years by which 21 exceeds the child's age as of decedent's death.

Example. If the child is 15, the deduction cannot be more than $30,000 [$5,000 × 6 (21 minus 15)].

Limitation if life estate or other terminable interest. The deduction is allowed for property passing to the minor child only to the extent that a marital deduction would have been allowable if the same property had passed to the decedent's surviving spouse. However, there is one exception. The orphans' deduction may be taken if the interest of the child is terminable only because the interest will pass to another person if the child having the interest dies before the youngest child of the decedent attains age 23.

Qualified minors' trust. The interest of a minor child in a qualified minors' trust is treated as an interest in property that passes or has passed from the decedent to a minor child.

A qualified minors' trust is a trust that meets the following requirements:

1) All the beneficiaries of the trust are the decedent's minor children, except as provided in (4),
2) The corpus of the trust is property that passes or has passed from the decedent to the trust,
3) All distributions from the trust to its beneficiaries before termination of their interests will be based on their shares, except as discussed later under *Certain disproportionate distributions*,
4) On the death of any beneficiary and before the termination of the trust, the beneficiary's share of the corpus and accumulated income either—
   a) Remains in the trust for the benefit of the decedent's minor children who survive the beneficiary, or
   b) Vests in any person, and
5) On the termination of the trust, each beneficiary will receive his or her share of the corpus and accumulated income.

Certain disproportionate distributions. A trust can still meet the distribution requirements in (3) even if the governing instrument of the trust permits disproportionate distributions that are limited by an ascertainable standard relating to their health, education, support, or maintenance.

Accumulation of trust income. A trust is not disqualified solely because the trustee has the power to accumulate income.

Death of beneficiary. A minor child's interest in a trust is not disqualified solely because that interest will pass to another if the child dies before the decedent's youngest child reaches age 23.

Deduction reduced by federal estate tax. If any death taxes must be paid out of the property passing to certain minor children, the orphans' deduction is reduced by the amount used to

pay the taxes. The payment of death taxes from a deductible interest causes a situation known as an ***interrelated computation*** of the federal estate tax. This computation is explained in Publication 904, *Interrelated Computations for Estate and Gift Taxes.*

After 1981. The orphans' deduction is not allowed for the estate of a person who died after 1981.

Form 706. The orphans' deduction for the estate of a person who died in 1981 is computed on Schedule N, Form 706.

Marital Deduction

The marital deduction is a deduction from the gross estate of the value of property that is included in the gross estate but that passes, or has passed, to the surviving spouse.

Property interests passing to the surviving spouse include any interest taken:

1) As the decedent's legatee, devisee, heir, or donee,
2) As the decedent's surviving tenant by the entirety or joint tenant,
3) As an appointee under the decedent's exercise of a power or as the taker in default if the decedent does not exercise a power, or
4) As the beneficiary of insurance upon the decedent's life.

Interests passing to the surviving spouse include dower (or curtesy) interests or the statutory interest in place of dower or curtesy, if elected. They also include an interest that, under community property laws, the surviving spouse had merely an expectant interest in before the decedent's death.

In order for property passing from a decedent to a surviving spouse to qualify for the marital deduction, the spouse must survive the decedent and be married to the decedent at the time of death. The marital deduction is not allowable with respect to transferred property if the decedent was not married to the transferee at the time of death even though the transferee was the decedent's spouse at the time of the transfer.

The parties are considered to have been married at the time of the decedent's death in spite of a prior ex parte divorce, if the divorce had been overturned by a court having personal jurisdiction over the spouses.

No marital deduction is allowed if the surviving spouse disclaims a property interest, it is considered as passing to the person entitled to receive that interest as a result of the disclaimer. However, if the surviving spouse receives an interest in property as a result of a qualified disclaimer by another person, that interest is considered as passing directly from the decedent to the surviving spouse and may qualify for the marital deduction. (See *Qualified Disclaimers*, in the *Gift Tax* section of this publication.)

Federal estate taxes or other death taxes that are paid out of the surviving spouse's share of the gross estate are not included in the value of property interests passing to the surviving spouse.

If a property interest that passes to a surviving spouse is subject to a mortgage or other encumbrance, or if an obligation is imposed upon the surviving spouse in connection with the passing of a property interest, the value of the interest must be reduced by the amount of the mortgage or other encumbrance.

A property interest passes to a surviving spouse when a will requires an executor to satisfy a debt of the surviving spouse for which the decedent had no liability. The amount of the bequest to satisfy the debt qualifies for the marital deduction.

Whenever a surviving spouse receives a bequest with a condition that he or she relinquish certain other property, the value of the conditional bequest is the amount by which it exceeds the value of the relinquished property. However, if the will or local law requires the executor to discharge the mortgage or other encumbrance out of other assets of the estate, or to reimburse the surviving spouse, the payment or reimbursement constitutes an additional interest passing to the surviving spouse.

Nondeductible Interests. Certain interests that pass to the surviving spouse do not qualify for the marital deduction. These nondeductible interests include:

1) A property interest that is not included in the decedent's gross estate.
2) A property interest that is transferred to the spouse to satisfy a claim against the estate. Similarly, if the surviving spouse is the executor of the estate and receives commissions deducted as an administration expense, no marital deduction is allowed for the commissions. (See the earlier discussion of administration expenses, etc.)
3) A property interest on which a deductible loss occurred during settlement of the estate. No marital deduction is allowed for this property to the extent of the deductible loss. (See *Casualty or Theft Losses*, discussed earlier.)
4) A property interest that is a *terminable interest*. However, there are exceptions to this nondeductible interest.

Terminable Interests

Certain interests in property passing from a decedent to a surviving spouse are referred to as ***terminable interests***. Such interests terminate or fail after the passage of time, or upon the occurrence or nonoccurrence of some contingency. Examples are life estates, annuities, estates for terms of years, and patents.

For the estate of a person who died before 1982, a terminable interest is nondeductible if:

1) Another interest in the same property passed from the decedent to some other person for less than adequate and full consideration in money or money's worth, and
2) Because it passed, the other person or that person's heirs may enjoy part of the property after the termination of the surviving spouse's interest.

For an estate of a person who died after 1981, see *After 1981*, later in this discussion.

Example 1. A decedent devised real property to his wife for life, with remainder to his children. The life interest that passed to the wife does not qualify for the marital deduction since it will terminate at her death and the children will thereafter possess or enjoy the property.

Example 2. Matthew Smith purchased a joint and survivor annuity for himself and his wife, who survived him. The value of the survivor's annuity, to the extent it is included in the gross estate, qualifies for the marital deduction. That is because even though the interest will terminate on the wife's death, no one else will possess or enjoy any part of the property.

Other nondeductible terminable interests. A property interest may be a nondeductible terminable interest even if it does not meet the above conditions. No marital deduction is allowed for a property interest that the executor must convert into a terminable interest for the surviving spouse. For example, a bequest of money is a nondeductible interest if the executor must use the money to purchase an annuity for the surviving spouse.

A property interest that may be satisfied out of a group of assets that includes a nondeductible interest will not qualify for the marital deduction to the extent of the value of the nondeductible interest. For example, suppose a surviving spouse is to receive one-third of the estate after all expenses are paid. The value of this bequest is $150,000. The estate includes a property interest that would be a nondeductible terminable interest if it passes to the surviving spouse. This interest is included in the gross estate at a value of $120,000. The executor has the right to satisfy the bequest by transferring this entire property interest to the surviving spouse. Therefore, the bequest is a nondeductible interest to the extent of $120,000. If only one-third of that interest can be used to satisfy the bequest, $40,000 is a nondeductible interest.

Exceptions. There are, however, exceptions to the terminable interest rule. A property interest passing from the decedent to the surviving spouse is not treated as a nondeductible terminable interest if:

1) It is a right to income for life with a power of appointment meeting the requirements discussed later,
2) It consists of life insurance or annuity payments held by the insurer with a power of appointment in the spouse, meeting the requirements discussed later, or
3) It is conditioned on the spouse's surviving for a limited period, in the manner described later.

Income interest with power of appointment. A property interest passing from the decedent to a surviving spouse is considered a deductible interest if it satisfies the following five conditions:

1) The surviving spouse is entitled to all or a specific part of the income from the entire interest or a specific part of it for life,
2) The income is payable annually or more frequently,
3) The surviving spouse has the power to appoint the entire interest to the surviving spouse or to his or her estate,
4) The surviving spouse must be able to exercise the power alone and in all events (although it may be limited to exercise either during life or by will), and
5) The interest is not subject to a power in any other person to appoint any part of the interest to anyone other than the surviving spouse.

If either the right to income or the power of appointment passing to the surviving spouse pertains only to a specific portion of a property interest passing from the decedent, the marital deduction is allowed only to the extent that the rights in the surviving spouse meet all of these five conditions. In determining whether a surviving spouse is entitled to receive all the income

from a specific portion of an interest, it is not necessary that the surviving spouse receive a fractional or percentile share of all the income from the entire interest. When a surviving spouse is entitled to receive a specified sum of income per year, the capital amount that would produce such a specified sum will be considered the specific portion from which the surviving spouse is entitled to receive the income.

Life insurance with power of appointment. A property interest consisting of the proceeds of a life insurance, endowment, or annuity contract that are held by an insurer and that pass from the decedent to the surviving spouse is considered a deductible interest if:

1) The surviving spouse is entitled to receive the proceeds in installments, or is entitled to interest on them, with all amounts payable during the surviving spouse's life and only to the surviving spouse,
2) The installment or interest payments are payable annually, or more frequently, beginning not later than 13 months after the decedent's death,
3) The surviving spouse has the power to appoint any amounts payable under the contract to the surviving spouse or to his or her estate,
4) The surviving spouse must be able to exercise the power alone and in all events (although it may be limited to exercise either during life or by will), and
5) The amount payable under the contract is not subject to a power in any other person to appoint any part of the amount to anyone other than the surviving spouse.

If these five conditions are met only for a specific portion of the proceeds, the rules for a partial interest in property are applicable in determining the extent of the allowable deduction.

Survival for limited period requirement. If a property interest passed from a decedent to a surviving spouse, subject to a provision that it was to pass to some other person if either the spouse dies within 6 months after the decedent's death or the decedent and the spouse should die as a result of a common disaster, the property interest is deductible if the spouse survived beyond the stated period or if the decedent and the spouse did not die as the result of a common disaster.

After 1981. New exceptions to the rule on a nondeductible terminable interest apply to the estate of a person who died after 1981. These exceptions are for *qualified terminable interest property* and *charitable remainder trusts.*

Qualified terminable interest property. Generally, a marital deduction is not allowed for a life estate that passes from a decedent to a surviving spouse, because the surviving spouse's interest terminates when he or she dies. However, you may elect the marital deduction for this interest if it meets the requirements of qualified terminable interest property. Make the election on the estate tax return. The election cannot be changed.

The term "qualified terminable interest property" means property that passes from the decedent and in which the surviving spouse has a *qualifying income interest for life.*

Property includes an interest in property. A specific portion of property is treated as separate property.

The surviving spouse has a ***qualifying income interest for life*** if:

1) The surviving spouse is entitled to all the income from the property,
2) The income is payable annually or more frequently, and
3) No person has the power to appoint any part of the property to anyone other than the surviving spouse.

Income interests granted for a term of years or life estates subject to termination if certain events occur (for example, if the surviving spouse remarries) do not qualify for this election. If any person, including the surviving spouse, can appoint any part of the property subject to the qualifying income interest to someone other than the surviving spouse, the interest does not qualify. However, a power that can be exercised only at or after the death of the surviving spouse does not disqualify the interest for purposes of making this election.

If the interest meets these requirements and you make the election, the entire property subject to the interest is treated as passing only to the surviving spouse. No one other than the surviving spouse is treated as having received any part of the property.

If the surviving spouse transfers all or part of the qualifying income interest, the transfer is subject to the gift tax. (See *Certain Marital Deduction Property* in the *Gift Tax* section of this publication.) If the surviving spouse did not dispose of the property, his or her gross estate will include the value of the property. (See *Certain Marital Deduction Property* discussed earlier under *Gross Estate.*)

Charitable remainder trusts. If the surviving spouse is the only noncharitable beneficiary of a qualified charitable remainder trust, the marital deduction is allowed for any interest in the trust that passes to the surviving spouse. A ***noncharitable beneficiary*** means any beneficiary of the trust other than an organization for which a charitable contribution deduction is allowed. A ***qualified charitable remainder trust*** is a charitable remainder annuity trust or a charitable remainder unitrust. These trusts are discussed later under *Charitable Deduction.*

The entire value of property transferred as an income interest for life to the surviving spouse and a remainder interest to charity may qualify for the marital deduction if you elect that treatment. See the earlier discussion under *Qualified terminable interest property.*

Limitation on Marital Deduction

For the estate of a person who died before 1982, the maximum estate tax marital deduction for property passing from a decedent to the surviving spouse is the ***greater*** of:

1) $250,000, or
2) 50% of the value of the decedent's adjusted gross estate.

The deduction is limited to the actual value of the interest that passes, or has passed, from the decedent to the surviving spouse.

The ***adjusted gross estate*** is the gross estate minus the following deductions:

1) Administration and funeral expenses,
2) Claims against the estate,
3) Any outstanding obligation to which property is subject, if the value of the property is included in the value of the gross estate and is undiminished by the outstanding indebtedness, and
4) Casualty and theft losses.

For determining the marital deduction, the gross estate is increased by any generation-skipping transfer occurring at the same time as, or within 9 months after, the death of a deemed transferor. For a further discussion, see *Deemed Transferor's Marital Deduction,* in the *Generation-Skipping Transfer Tax* section of this publication.

Reduction for gifts to spouse. The limitation on the marital deduction is reduced by certain gifts to the surviving spouse. The limitation is reduced by the amount by which the gift tax marital deduction allowed exceeds 50% of the value of the gifts made after 1976 for which a gift tax return was required. This reduction will only apply if the total transfers qualifying for the gift tax marital deduction are less than $200,000. Gifts to a spouse included in the gross estate as ***transactions within 3 years of death*** are not taken into account for purposes of computing the amount of the reduction. The gift tax marital deduction is discussed under *Marital Deduction,* in the *Gift Tax* section of this publication.

Community property adjustment. If the gross estate includes community property, both the $250,000 amount and the adjusted gross estate have to be reduced before computing the limitation on the marital deduction.

Computation of adjusted gross estate. To arrive at the adjusted gross estate reduce the entire value of the gross estate by the following:

1) The value of the community property held by the decedent at death, and
2) The value of the community property transferred by the decedent during life, and
3) The insurance proceeds of policies on the life of the decedent to the extent they were purchased with community funds, and
4) An amount that bears the same ratio to the ***total allowable deductions*** for expenses, indebtedness, taxes, and losses that the value of the total gross estate reduced by (1), (2), and (3) (the decedent's community property interest) bears to the value of the entire gross estate.

The amount of the ***total allowable deductions*** under (4) is ***all*** the allowable deductions whether they are attributable to community property interests or noncommunity property interests. The amounts in (1), (2), and (3) must have been included in the gross estate.

Reduction of the $250,000 limitation. The $250,000 amount must be reduced by the following:

A) The total of the amounts just listed in items (1), (2), and (3);

minus

B) The excess of the total allowable deductions for expenses, indebtedness, taxes, and losses ***over*** the amount just figured in (4).

Example. The total value of John Hawthorne's estate is $300,000. Of this, $200,000 is his separate property that he inherited from his father, and $100,000 represents his one-half interest in community property. The total debts and expenses are $45,000. The entire estate passes to his wife. The adjusted gross estate

and the limitation on the marital deduction is computed as follows:

Value of the total gross estate		$300,000
Reduction under (1)		
Value of community property held at death	$100,000	
Reduction under (4)		
$200,000 / $300,000 × $45,000	30,000	
Total reduction		130,000
Adjusted gross estate		$170,000
One-half of the adjusted gross estate		$ 85,000

The dollar limitation on the marital deduction is computed as follows:

Dollar limitation		$250,000
Reduction:		
Community property	$100,000	
Minus: Total debts and expenses	$45,000	
Minus: Reduction under (4)	30,000	
	15,000	
Total reduction		85,000
Reduced dollar limitation		$165,000

The limitation on the marital deduction is $165,000.

Converted property. The example above illustrates the computation of the marital deduction when the decedent's gross estate includes separate property that had not been converted from community property.

If the gross estate includes separate property that was converted from community property after 1941 or that is traceable to such converted community property, that separate property is considered community property for purposes of computing the marital deduction.

After 1981. The limitation on the marital deduction does not apply to the estate of a person who died after 1981. For these estates, the amount of the marital deduction is the value of property passing to the surviving spouse, if the property qualifies for the deduction.

Since the deduction is unlimited, you do not have to reduce the deduction for gifts the decedent made to the spouse or make any adjustment for community property included in the gross estate. In addition, to determine the marital deduction, you do not have to increase the gross estate by any generation-skipping transfers occurring at death or within 9 months after death.

The unlimited marital deduction does not apply to the estate of a decedent who died after 1981 if:

1) The property passes under a will executed before September 12, 1981, or a trust created before that date, that contains a maximum marital deduction formula,
2) The formula was not amended after September 12, 1981, and before the death of the decedent to refer specifically to the unlimited marital deduction, and
3) The state does not enact a law applicable to the estate that construes the formula as referring to the unlimited marital deduction.

Deduction Reduced by Death Taxes

If death taxes must be paid out of the property passing to a surviving spouse, the marital deduction is reduced by the amount used to pay the taxes. The marital deduction is likewise reduced if the executor has the discretionary power to pay any death taxes from the marital interest, regardless of whether the executor uses that discretion. The marital deduction is limited to the value of property that could not have been allocated for the payment of death taxes. The payment of death taxes from a deductible interest causes a situation known as an ***interrelated computation*** of the federal estate tax. This computation is explained in Publication 904, *Interrelated Computations for Estate and Gift Taxes.*

Form 706

In general, property interests included in the gross estate that pass from the decedent to the surviving spouse for which a marital deduction is allowed should be listed on Schedule M, Form 706. For estates of decedents who died before 1982, the amount of the marital deduction is computed on page 3, *Recapitulation,* of Form 706. See the instructions to the form for additional information.

Charitable Deduction

A deduction is allowed for the value of property in the decedent's gross estate that the decedent transferred during life or by will to or for the use of any of the following:

1) The United States, a state, a political subdivision of a state, or the District of Columbia, for exclusively public purposes,
2) Any corporation or association organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art, or to foster national or international amateur sports competition (but only if none of its activities involve providing athletic facilities or equipment) and the prevention of cruelty to children or animals, as long as no part of the net earnings benefits any private individual and no substantial activity is undertaken to carry on propaganda, or otherwise attempt to influence legislation or participate in any political campaign on behalf of any candidate for public office,
3) A trustee or a fraternal society, order, or association operating under the lodge system, if the transferred property is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, and no substantial activity is undertaken to carry on propaganda or otherwise attempt to influence legislation, or participate in any political campaign on behalf of any candidate for public office,
4) Any veterans organization incorporated by an Act of Congress or any of its departments, local chapters, or posts, for which none of the net earnings benefits any private individual, or
5) A foreign government or its political subdivision when the use of such property is limited exclusively to charitable purposes.

Transfers subject to a condition or power. If a transfer to a qualified charity is contingent upon some act or occurrence, a deduction is allowable only if it is virtually certain that the transfer will become effective and the contingency can be ignored.

If the donee or the trustee has the power to divert any part of the property or fund for a use or purpose that is not deductible, only the portion of the property or fund not subject to this power is deductible.

Disclaimers. The charitable deduction is allowed for amounts that are transferred to charitable organizations as a result of either a qualified disclaimer or the complete termination of a power to consume, invade, or appropriate property for the benefit of an individual. It does not matter whether termination occurs because of the death of the individual or in any other way. The termination must occur within the period required for a qualified disclaimer and before the power has been exercised. See *Qualified Disclaimers,* in the *Gift Tax* section of this publication.

Payments in compromise. If a charitable organization assigns or surrenders a part of a transfer to it under a compromise agreement to settle a controversy, the amount surrendered or compromised is not deductible as a transfer to that charitable organization.

Payment of death taxes. The deduction is limited to the amount actually available for charitable uses. Thus, if under the terms of a will or the provisions of local law, the federal estate tax or any other death tax is payable in whole or in part out of property that is transferred as a charitable deduction, the deduction is the amount of the transferred property reduced by these taxes. However, the charitable deduction allowable for the residue of an estate is not reduced by the amount of state inheritance taxes that would be imposed upon the exercise of a power of appointment over trust property, if the donee (receiver) of the power dies before the due date for filing the decedent's estate tax return, without having exercised the power.

If you elected to make installment payments of the estate tax, you must reduce the charitable deduction by an estimate of the maximum amount of interest that will be payable on the deferred taxes if the interest is payable out of property transferred to charity. It does not matter if the interest deduction is taken on the estate tax return or on the estate's income tax return.

The payment of death taxes from a deductible interest causes a situation known as an ***interrelated computation*** of the federal estate tax. This computation is explained in Publication 904.

Powers of appointment. The charitable deduction is allowed for property passing to charity by the exercise, release, or lapse of a power of appointment, if the property is included in the decedent's gross estate.

Partial interests. Sometimes an interest in property passes from the decedent for charitable purposes and another interest (other than an interest that is extinguished upon the decedent's death) in the same property passes from the decedent for private purposes for less than an adequate and full consideration in money or money's worth. When this occurs, a deduction is allowed for the value of the interest that passes for charitable purposes only if the interest is deductible under (1) through (6) below. If at the date of a decedent's death, a transfer for private purposes is dependent upon the performance of some act or the happening of some precedent event in order to be effective, the interest is considered to pass for a private purpose unless the possibility of the occurrence of the act or event is so remote as to be negligible.

1) ***An undivided portion of the decedent's entire interest.*** If the decedent, at death, transferred for a charitable purpose an undivided interest, ***not in trust,*** of his or her entire in-

terest in property, the value of the interest is a deductible charitable contribution. An undivided portion of a decedent's entire interest in property must consist of a fraction, or a percentage, of each and every interest or right owned by the decedent in the property. It must also extend over the entire term of the decedent's interest in that property or in other property into which the donated property is converted.

2) ***Remainder interest in a personal residence.*** If the decedent, at death, transferred for a charitable purpose the remainder interest, ***not in trust,*** in his or her personal residence, the value of the interest is a deductible charitable contribution.

The term ***personal residence*** means any property the decedent used as a residence, even though it is not used as a principal residence. This would include a vacation home. The term also includes stock owned by the decedent as a tenant-stockholder in a cooperative housing corporation, if the decedent used the dwelling he or she was entitled to occupy as a personal residence. A residence does not include household furnishings that are not fixtures. The charitable remainder interest must be in the residence itself and not in the proceeds to be derived from the sale of the residence.

3) ***Remainder interest in a farm.*** If the decedent, at death, transferred the remainder interest, ***not in trust,*** in a farm to a qualified charity, the value of that interest is deductible.

A farm for this purpose means ***any*** land used by the decedent or a tenant to produce crops, fruits, or other agricultural products, or to sustain livestock. A farm includes improvements on the farm.

Note. You cannot elect the special-use valuation method for a farm, discussed earlier, if the remainder interest is transferred to a charity.

4) ***Qualified conservation contribution.*** A transfer of a qualified real property interest to a qualified organization exclusively for conservation purposes is a deductible charitable contribution.

Conservation means the preservation of land areas for public outdoor recreation or education; the preservation of open space; the preservation of historically important land areas or certified historic structures; or the protection of natural habitats.

For more information on qualified conservation contributions, see Publication 526, *Charitable Contributions.*

5) ***Remainder interests, charitable remainder trusts, and pooled-income funds.*** A charitable deduction is allowed for the transfer by the decedent of a remainder interest for a charitable purpose in certain cases. The charitable remainder must be in a trust. The trust must be in the form of a charitable remainder annuity trust, a charitable remainder unitrust, or a pooled-income fund.

In the case of a charitable remainder annuity trust and a charitable remainder unitrust, the governing instrument must provide that the obligation to pay the unitrust or annuity amount begins on the date of death, in order for the charitable interest to qualify for the estate tax charitable deduction. The instrument must also provide for corrective payments if an annuity or unitrust amount determined to be payable is underpaid or overpaid.

These rules apply only for transfers to charitable remainder trusts by decedents dying after May 5, 1980, except that they do not apply in the case of transfers under the terms of wills executed on or before May 5, 1980:

a) If the decedent dies after May 5, 1980, but before May 5, 1981, without having amended any dispositive provision of a will after May 5, 1980, by codicil or otherwise,

b) If the decedent dies after May 5, 1980, and at no time after that date had the right to change the portions of a will which pertain to the passing of the property to, or for the use of, an organization qualifying for a charitable contribution, or

c) If no dispositive provision of the will is amended by the decedent, by codicil or otherwise, after May 5, 1980, and before May 5, 1981, and the decedent is on May 5, 1981, and at all times thereafter under a mental disability to amend the will by codicil or otherwise.

A charitable remainder annuity trust is a trust from which a specified amount is paid at least annually to one or more persons who were living at the time the trust was created. The amount must be at least 5% of the initial net fair market value of all property in the trust. At the death of the last income beneficiary, or at the end of a term of up to 20 years, the remainder interest must be held for the benefit of a qualified charitable organization or paid to it.

Generally, a ***charitable remainder unitrust*** is a trust from which a fixed percentage of the net fair market value of its assets, valued annually, is paid at least annually to one or more persons who are living at the time of the creation of the trust. The percentage must be at least 5%. At the death of the beneficiaries or at the end of a term of up to 20 years, the remainder interest is held for the benefit of a qualified charitable organization or paid to it.

A pooled-income fund is a trust that is maintained by a charity to which individuals transfer property. The trust provides a proportionate income interest in all the trust property to a beneficiary for life. The beneficiary must be living at the time of the decedent's death.

Any other form of charitable remainder interest will not qualify for the charitable deduction.

6) ***Income interests, guaranteed annuity interests, and unitrust interests.*** If the decedent transfers an ***income interest,*** whether or not in trust, to a charity and the remainder to a noncharitable entity, the charitable deduction is disallowed. However, it is allowed if the income interest is in the form of a guaranteed annuity interest or unitrust interest.

The term ***guaranteed annuity interest*** is the right, under the instrument of transfer, to receive a determinable amount for a specified term or for the life or lives of an individual or individuals. The amount must be paid at least annually and the individual or individuals receiving the interest must be living at the date of death of the decedent.

For example, the annuity may be paid for the life of an individual plus a term of years. An amount is determinable if the exact amount that must be paid under the conditions specified in the instrument of transfer can be ascertained as of the appropriate valuation date.

A guaranteed annuity interest, not in trust, must be paid by an insurance company or by an organization regularly engaged in issuing annuity contracts.

The term ***unitrust interest*** means the right, under the instrument of transfer, to receive payment at least annually of a fixed percentage of the net fair market value, determined annually, of the property that funds the unitrust.

A unitrust interest, not in trust, must be paid by an insurance company or by an organization regularly engaged in issuing interests otherwise meeting the requirements of a unitrust interest.

After 1981. Generally, a contribution of a copyrightable work of art would qualify for the charitable contribution deduction only if the copyright on the work of art was also transferred to the charitable organization. For the estate of a person who died after 1981, the work of art and its copyright are treated as separate properties if there is a qualified contribution. The term ***work of art*** means any tangible personal property for which there is a copyright under federal law.

A ***qualified contribution*** is the transfer of property to a qualified organization if the use of the property is related to the organization's exempt purpose or function. A ***qualified organization*** is any religious, charitable, scientific, educational, or other organization described in section 501(c)(3) of the Code that is not a private foundation.

Partial interests, valuation. The amount of the deduction in the case of a partial interest (including a remainder interest) is the fair market value of the interest on the appropriate valuation date. The fair market value of an annuity, life estate, term for years, remainders, reversion, or unitrust interest is its present value. See the discussion under *Valuation.*

State or foreign death taxes. For treatment of state or foreign death taxes imposed on a transfer to a charity, see the discussion under *Administration Expenses, Funeral Expenses, Claims, and Obligations,* and *Credit for State Death Taxes.*

Form 706. Charitable transfers are listed on Schedule O, Form 706.

Estate Tax Computation

The taxable estate is the ***total gross estate*** minus:

1) Administration and funeral expenses,
2) Claims against the estate and obligations,
3) Casualty and theft losses,
4) Orphans' deduction,
5) Marital deduction, and
6) Charitable deduction.

There is one ***Unified Rate Schedule*** that applies to both estate and gift taxes. The schedule is used to determine the tentative tax on the taxable amount (taxable estate or taxable gift). The Unified Rate Schedule can be found at the end of this publication.

The ***gross estate tax*** before the allowance of any credit is an amount equal to:

1) A tentative tax on the sum of—
   a) The amount of the taxable estate, and
   b) The amount of the ***adjusted taxable gifts;***

Minus

2) The total amount of ***tax payable*** for gifts made after 1976.

The ***adjusted taxable gifts*** include only the value of the taxable gifts that were made by the decedent after 1976 and that are ***not includible***

in the decedent's gross estate. For example, before 1982, taxable gifts made after 1976 but within 3 years of the decedent's death are not considered adjusted taxable gifts because they are already included in the tax computation. However, for the estate of a decedent who died after 1981, gifts generally are not included in the gross estate. For these estates, the gifts will be included in the amount of the adjusted taxable gifts for purposes of determining the tentative tax.

The ***tax payable*** on gifts made after 1976 for estate tax purposes is the amount by which the gift tax payable exceeds the appropriate unified credit amount.

After 1981. For the estate of a person who died after 1981, the estate tax reduction for gift taxes payable on gifts made after 1976 (item (2) in the computation) is based on the rate schedule in effect at the time of death. For example, in 1980 Joan Green made a gift that was taxed at the maximum rate (70%). If Joan dies in 1984, the estate tax reduction for the gift tax payable on the 1980 gift is based on the 1984 rate schedule, which has a maximum rate of 55%.

Adjustment for gift tax paid by spouse. If one-half of a gift made by a decedent is considered made by the decedent's spouse, and if the amount of the gift is includible in the decedent's gross estate, any tax payable by the spouse is treated as a tax payable on a gift made by the decedent. It therefore is included as an offset against the tentative estate tax.

Split gifts made within 3 years of death of spouse. A gift is not included in computing the adjusted taxable gifts of a decedent if:

1) The decedent's spouse was the donor of a gift (one-half of which was considered as made by the decedent), and
2) The gift was included in the gross estate of the decedent's spouse as a ***transaction within 3 years of death.***

Also, the total tax payable for gifts made after 1976 is reduced by the amount of gift tax payable that was treated as a tax payable for the gift made by the decedent's spouse.

U.S. military personnel. A special benefit is provided for U.S. military personnel who die as a result of service in a combat zone. The decedent must have been a U.S. citizen or resident and must have died during active service. Death must have been caused by wounds, injury, or disease suffered in a combat zone, in the line of duty, by reason of a hazard to which the individual was subjected in the course of such service.

The estates of military personnel missing in action during the Vietnam conflict also qualify for this benefit if they are determined to have been killed in action, regardless of the date of the determination.

The benefit provides an exemption from the additional estate tax but not from the basic tax. The basic estate tax is 125% of the maximum state death tax credit. (See *Credit for State Death Taxes.*) The additional estate tax is the difference between:

1) The federal estate tax (before credits), computed by using the Unified Rate Schedule, and
2) The basic estate tax.

Any credits allowed for these estates are applied against the basic estate tax. These credits include the unified credit, state death tax credit, and the other credits discussed later.

Estate tax recovery. The estate may recover any estate tax that is attributable to certain marital deduction property included in the gross estate. The taxes may be recovered from the person or persons receiving the property. See *Certain Marital Deduction Property* discussed earlier under *Gross Estate*, and *Reimbursement of Estate Tax* discussed later under *Miscellaneous Provisions*.

Credits Against the Tax

The following credits are deducted from the gross estate tax to determine the ***net estate tax payable:***

1) Unified credit,
2) Credit for state death taxes,
3) Credit for gift taxes,
4) Credit for tax on prior transfers, and
5) Credit for foreign death taxes.

Unified Credit

The amount of the unified credit allowed the estates of individuals dying in 1981 is $47,000. The credit is increased as follows:

For individuals dying in:	The credit is:
1982	$ 62,800
1983	$ 79,300
1984	$ 96,300
1985	$121,800
1986	$155,800
1987 and later	$192,800

Adjustment. The amount of the unified credit available must be reduced by 20% of the amount of the ***specific lifetime exemption*** (section 2521 as in effect before its repeal by the Tax Reform Act of 1976) allowed for gifts made after September 8, 1976, and before 1977.

Example. If an individual died in 1982 and had made no prior gifts, the amount of the available unified credit against the gross estate tax would normally be $62,800. However, if the decedent had made a taxable gift of $15,000 on October 1, 1976, and elected to use $15,000 of the available lifetime exemption for the gift, as provided under prior law, the unified credit available to the decedent's estate would be $59,800 ($62,800 − $3,000 (20% × $15,000)) rather than the full $62,800.

The amount of the unified credit claimed may not be more than the amount of the tax imposed. Therefore, the excess unused unified credit may not be claimed as a refund.

Credit for State Death Taxes

A credit is allowed for any estate, inheritance, legacy, or succession tax ***actually paid*** to any state or the District of Columbia, on account of any property included in the gross estate of the decedent.

Use the ***Maximum Credit for State Death Taxes*** table at the end of this publication to compute the maximum amount of this credit.

The allowable credit is computed using the ***adjusted taxable estate,*** rather than the taxable estate. The ***adjusted taxable estate*** is the taxable estate reduced by $60,000.

The credit for state death taxes may not be more than the amount of the gross estate tax reduced by the unified credit.

Deduction. If a state imposes a death tax on a ***charitable transfer*** and a deduction is claimed for the tax, the credit for state death taxes is limited to the least of:

1) The amount of state death taxes paid minus the amount of the deduction claimed,
2) The maximum credit allowable to the decedent's estate using the table for credit for state death taxes, or
3) $\frac{\text{All the state death taxes minus those imposed on the charitable transfer}}{\text{All state death taxes}} \times \text{The maximum credit computed without the deduction for state death taxes}$

Credit for death taxes on remainder. If the election is made to postpone paying any portion of the federal estate tax attributable to a remainder or a reversionary interest in property, the credit may be taken against that portion of the federal estate tax for state death taxes attributable to the reversionary or remainder interest. This applies if the state death taxes are paid and claimed as a credit any time before the expiration of the time for payment.

Limitation period. The credit applies only to taxes that actually were paid and for which the credit was claimed within 4 years after filing the estate tax return. You must submit proof that the taxes have been paid. Any inheritance tax considered paid by a credit of state gift tax paid at any time is not allowable as a credit.

If a timely petition for a redetermination of a tax deficiency has been filed with the Tax Court, the credit may be claimed within the 4-year period or 60 days after the Tax Court decision becomes final, whichever is later.

If an extension of time for paying the estate tax or a deficiency has been granted, the credit may be claimed by the end of the 4-year period or the expiration of the extended time for payment, whichever is later.

If a timely claim for refund of or credit for an overpayment of tax has been filed, the claim for the credit for state death taxes may be filed by the ***later of:***

1) The expiration of the normal 4-year period, or
2) 60 days from the date of a notice of the disallowance of any part of the claim for credit or refund, or
3) 60 days from the date a decision of any court of competent jurisdiction becomes final.

Refunds of estate tax based on the allowance of the state death tax credit are made without interest.

Credit for Gift Taxes

No credit is allowed for any gift tax paid on gifts made after 1976.

Gift made before 1977. Credit is allowed against the estate tax for the federal gift tax paid on a gift made by a decedent, if the property is included in the gross estate. The credit is allowable even if the gift tax is paid after the decedent's death and the amount of the gift tax is deducted from the gross estate as a debt of the decedent.

The credit is allowed only when the gift tax has been paid on the transfer of nonprobate assets and double taxation would result.

Limitation. The credit is limited to the lesser of:

1) The gift tax paid on the gift that is included in the gross estate, or
2) The amount of estate tax attributable to the inclusion of the gift in the decedent's gross estate.

Limitation 1. If the gift included in the gross estate was the only one made in a given calendar quarter (or calendar year, if made before

1971), the amount of the limitation is the gift tax paid for that quarter (or year). If the included gift is only one of several made in a given calendar quarter (or year, if pre-1971), the amount under this limitation is a fraction of the gift tax paid for that quarter (or year). The numerator of the fraction is the amount of the included gift reduced by any portion excluded or deducted; and the denominator is the total taxable gifts increased by the specific exemption allowed. The values used are those determined for purposes of the gift tax.

Example. Assume the following facts: the included gift was valued at $63,000 for gift tax purposes and that an exclusion of $3,000 was applicable; the total amount of taxable gifts was $210,000 after deduction of a specific exemption of $30,000; and the gift tax paid was $40,275. The amount under ***limitation (1)*** would be computed as follows:

$$\frac{\$\ 63,000 - \$3,000}{\$210,000 + \$30,000} \times \$40,275 = \$10,068.75$$

Limitation 2. The amount under this limitation is a fraction of the gross estate tax reduced by any credit for state death taxes and the unified credit. The numerator is the value of the gift, and the denominator is the value of the entire gross estate reduced by any amount allowed as charitable and marital deductions. For this purpose, the ***value of the gift*** is the value included in the gross estate, or the value for purposes of the gift tax, whichever is lower, reduced by all or a portion of any annual exclusion allowed for gift tax purposes and by any amount allowed as charitable and marital deductions. If the gift tax value is lower than the estate tax value, it is reduced by the amount of the entire annual exclusion. If the estate tax value is lower, it is reduced by only a portion of the annual exclusion that is computed by multiplying the estate tax value of the gift by a fraction. The numerator is the annual exclusion, and the denominator is the gift tax value.

Example. Assume that a gift by the decedent, valued at $30,000 for gift tax purposes, is included in his gross estate at a value of $27,000. Also assume that an exclusion of $3,000 had been allowed. The value of the gift for this purpose would be:

$$\$27,000 - \left[\frac{\$3,000}{\$30,000} \times \$27,000\right] = \$24,300.$$

If a charitable or marital deduction were allowed the estate in this example, the amount of the gift also would have to be reduced by a proportionate part of any such deduction.

Credit for Tax on Prior Transfers

Credit is allowed against the gross estate tax for federal estate taxes paid on the transfer of property to the decedent from a transferor who died within 10 years before or 2 years after the decedent's death. For this purpose, property means any beneficial interest in property. This includes a general power of appointment. Examples of this type of property include annuities, life estates, remainders, and other future interests.

The transferred property does not have to be identified in the decedent's estate. It does not have to exist at the time of death. What matters is that the transfer of the property to the decedent was subject to federal estate tax in the estate of the transferor and that the transferor died within the prescribed period of time.

Limitation. The credit is limited to the smaller of the following amounts:

1) The amount of the federal estate tax attributable to the transferred property in the transferor's estate, or
2) The amount of the federal estate tax attributable to the transferred property in the decedent's estate.

Percentage allowable. If the transferor died within 2 years before or 2 years after the decedent's death, the credit is the smaller of limitation (1) or (2). If the transferor died more than 2 years before the decedent, the credit is a percentage of the smaller of either limitation (1) or (2) as follows:

a) 80%, if the transferor died within the 3rd or 4th year before the decedent's death,
b) 60%, if within the 5th or 6th year,
c) 40%, if within the 7th or 8th year, and
d) 20%, if within the 9th or 10th year.

Limitation 1. The amount of limitation (1) is a fraction of the transferor's adjusted federal estate tax. The numerator is the value of the transferred property, and the denominator is the transferor's adjusted taxable estate.

The transferor's ***adjusted federal estate tax*** is the amount of federal estate tax paid on the transferor's estate, plus any credit allowed that estate for gift tax and any credit allowed that estate for tax on prior transfers. However, the credit for tax on prior transfers is added only if the transferor acquired property from a person who died within 10 years before the death of the decedent.

The transferor's ***adjusted taxable estate*** is the amount of the transferor's taxable estate decreased by the amount of any death taxes paid with respect to the gross estate (and increased by the amount of the exemption, $60,000, allowed in computing the taxable estate if the transferor died before 1977). The ***death taxes,*** for this purpose, are the federal estate tax plus the net amount of all other estate, inheritance, legacy, succession, or similar taxes imposed by and paid to any taxing authority, whether within the United States or not.

The value of the ***transferred property*** is the value used to determine the transferor's federal estate tax liability, reduced by the following:

1) The amount of any death taxes payable out of the transferred property or paid by the decedent in connection with it,
2) The amount of any encumbrance on the property or obligation imposed by the transferor upon the property and incurred by the decedent with respect to it, and
3) The amount of any marital deduction allowed the transferor's estate if the decedent was the transferor's spouse at the time of the transferor's death.

Limitation 2. The amount of limitation (2) is the excess of:

1) The net estate tax payable on the decedent's estate, determined without regard to the ***credit for tax on prior transfers,*** and without regard to any credit for foreign death taxes claimed under the provisions of a death tax convention, over
2) The net estate tax determined in a similar manner, but computed after subtracting from the decedent's gross estate the value of the property transferred.

For purposes of determining the reduced gross estate, any charitable deduction allowable to the decedent's estate is reduced by an amount having the same ratio to that charitable deduction as the value of the transferred property has to the value of the decedent's adjusted gross estate. If a marital deduction is allowable, it is limited to the value of the property passing to the spouse. However, if the decedent died before 1982, the deduction cannot be more than 50% of the reduced adjusted gross estate or $250,000, whichever is greater, for the purpose of computing the net estate tax.

Certain real property. If the gross estate of the transferor included real property, such as a farm or other closely held business, for which the special-use valuation election was made (as discussed earlier in *Special Farm or Other Closely Held Business Real Property Valuation*), and if the additional estate tax is imposed on the transferor's estate within 2 years of the decedent's death because the property was disposed of or ceased to be used for a qualified use, the additional tax is treated as a federal estate tax payable on the transfer of the decedent's estate. Further, the value of such property and the amount of the transferor's taxable estate is determined as if the special valuation had not been elected.

Generation-skipping transfer. If there was a generation-skipping transfer of any property included in the decedent's estate, and if ***the deemed transferor was not alive*** at the time of the transfer, the property is considered to have passed to the decedent from the deemed transferor. Generation-skipping transfers are discussed later.

The tax on the generation-skipping transfer in such circumstances is treated as a federal estate tax payable by the deemed transferor's estate. The deemed transferor's taxable estate shall be increased by the value of such property used to determine the generation-skipping tax.

Form 706. The credit for tax on prior transfers is figured on Schedule Q, Form 706.

Credit for Foreign Death Taxes

Credit is allowed against the gross estate tax for any estate, inheritance, legacy, or succession taxes actually paid by the decedent's estate to any foreign country. The term ***foreign country*** includes possessions or political subdivisions of foreign states and possessions of the United States.

The credit is allowed for death taxes paid with respect to property:

1) Situated within the foreign country to which the tax is paid, and
2) Included in the decedent's gross estate.

No credit is allowed for such taxes paid for the estate of a person other than the decedent. No credit is allowed for interest or penalties relating to foreign death taxes.

The credit is allowable to the estate of a decedent who, at the time of death, was a citizen of the United States. It also is allowable to the estate of a decedent who was a resident but not a citizen of the United States at the time of death. However, it is not allowed if a proclamation issued by the President of the United States denies the foreign death tax credit to citizens of the foreign country of which the decedent was a citizen. No credit is allowable to the estate of a decedent who was neither a citizen nor resident of the United States at the time of death.

The same principles apply for determining whether a particular property included in a decedent's gross estate is situated in the foreign country imposing the tax as for determining whether similar property of a nonresident noncitizen decedent is situated within the United States for federal estate tax purposes. (See *Location of Property* under *Estates of Nonresident Noncitizens.*) If the tax is imposed by a political subdivision of a foreign country, the tax credit may be allowed even though the property involved is situated in a political subdivision different from the one imposing the tax.

Limitation. The credit is limited to the lesser of the following:

1) The amount of the foreign death tax attributable to the property situated in the country imposing the tax and included in the decedent's gross estate for federal estate tax purposes, or
2) The amount of the federal estate tax attributable to particular property situated in a foreign country, subject to death tax in that country, and included in the decedent's gross estate for federal estate tax purposes.

Exchange rate. When computing the credit, convert death taxes paid to the foreign country into U.S. dollars by using the rate of exchange in effect at the time each payment of foreign tax is made.

Limitation 1. The amount of limitation (1) is a fraction of the tax imposed by the foreign country, without allowance of any credit for U.S. estate tax. The numerator is the value of the property situated in the foreign country subjected to the foreign tax and included in the decedent's gross estate for federal estate tax purposes. The denominator is the value of all the property subjected to the foreign tax. The values used in this computation are those used by the foreign jurisdiction in imposing its tax. If a foreign country imposes more than one kind of death tax or imposes tax at different rates upon the several shares of an estate, or if a foreign country and its political subdivision or possession each imposes a death tax, make separate computations and add the results to determine the amount of limitation (1).

Limitation 2. The amount of limitation (2) is a fraction of the gross federal estate tax reduced by the unified credit, any credit for state death taxes, and any credit for gift tax. The numerator is the adjusted value of the property situated in the foreign country, subjected to the foreign death tax, and included in the gross estate. The denominator is the value of the entire gross estate, reduced by the total amount allowed as a charitable deduction and as a marital deduction. The values used in this computation are those determined for purposes of the federal estate tax. The ***adjusted value of the property situated in the foreign country*** is the value of the property in the foreign country that meets the requirements for credit, reduced by the amount of any allowable charitable and marital deductions attributable to such property.

Example. A U.S. citizen died in 1981 and left a gross estate consisting of shares of stock issued by a U.S. corporation valued at $750,000, and property situated in Country X valued at $250,000, on which death taxes were paid to Country X. Expenses, indebtedness, etc., amounted to $30,000. The decedent bequeathed $20,000 of the U.S. stocks and $50,000 of the property in Country X to a U.S. charity. The balance of the estate was bequeathed to his son. The gross federal estate tax is $306,800, the available unified credit is $47,000, and the credit for state death taxes is $27,600. The amount of limitation (2) is $49,935 computed as follows:

$$\frac{\$250,000 - \$50,000}{\$1,000,000 - \$70,000} \times (\$306,800 - \$47,000 - \$27,600)$$

Death tax conventions and the credit. In addition to the credit for foreign death taxes under the provisions of federal estate tax law, similar credits are allowed under death tax conventions with a number of foreign countries, discussed later.

If credit is allowable either under the provisions of law or under the provisions of a convention, the credit that is allowed is the one most beneficial to the estate. If property of the estate is subjected to tax by a country with which the United States has a convention, and also by a political subdivision or possession of that country, the estate is allowed the most beneficial of the following:

1) A credit for the combined death taxes paid to the foreign country and its political subdivisions or possessions as provided for by the convention,
2) A credit for the combined death taxes paid to the foreign country and its political subdivisions or possessions as determined under the provisions of law, or
3) A credit for that amount of the combined death taxes paid to the foreign country and its political subdivisions or possessions as allowed under the convention, and a further credit, determined in the regular manner, for the death taxes paid to each political subdivision or possession to the extent the death taxes are not covered by the convention.

Taxes imposed by two foreign countries. Sometimes a credit is allowable for tax paid to more than one foreign country. The credit may be determined under the provisions of law or under a convention. In such cases, the credits are combined and the total amount is credited against the federal estate tax. The amount allowable is limited, however, to the amount of the federal estate tax attributable to the property involved, determined according to the rules for computing the amount of limitation (2).

Note. If the foreign death taxes that are paid on charitable transfers are deducted rather than credited, the value of that property is ***excluded*** in computing limitation (1) and (2).

Credit for death taxes on remainders. If the election is made to postpone paying any portion of the federal estate tax attributable to a remainder or reversionary interest in property, the credit may be taken against that portion of the federal estate tax for foreign death taxes attributable to the reversionary or remainder interest. This applies if the foreign death taxes are paid and claimed as a credit anytime before the expiration of the time for payment.

Limitation period. The credit for foreign death taxes is limited to those taxes that actually were paid and for which a credit was claimed within the later of the 4 years after the filing of the estate tax return, or before the date of expiration of any extension of time for paying the federal estate tax, or 60 days after a final decision of the Tax Court on a timely filed petition for a redetermination of a deficiency.

Form 706. The credit for foreign death taxes is figured on Schedule P, Form 706. Form 706CE, *Certification of Payment of Foreign Death Tax,* is also required.

Recovery of Taxes Claimed as Credits

If any amount of taxes claimed as a credit for state death taxes or for foreign death taxes is refunded, the executor or any other person recovering the taxes must notify the Internal Revenue office where the estate tax return was filed within 30 days of its receipt. The Internal Revenue Service will redetermine the federal estate tax. No interest is assessed on any amount of tax due because of a refund of foreign taxes paid, except to the extent the foreign country paid interest on the refund. The person who receives the refund must pay any federal estate tax found to be due as a result of the refund. This applies even if the refund is received after the expiration of the period of limitations. The notice must include the following:

1) The name of the decedent,
2) The date of death,
3) The property with respect to which the refund was made,
4) The amount of the refund, not including interest,
5) The date of the refund, and
6) The name and address of the person receiving the refund.

If the refund is of foreign taxes, the notice must contain a statement showing the amount of any interest paid by the foreign country on the refund.

Examples of Estate Tax Computation

The following examples illustrate the computation of the estate tax.

Example 1. Robert Jones died in 1981. His gross estate is valued at $800,000. He made no lifetime taxable gifts. His surviving spouse is to receive all the assets of the estate. The estate tax is computed as follows:

Gross estate	$800,000
Minus: Debts and administration expenses	200,000
Adjusted gross estate	$600,000
Minus: Marital deduction	300,000
Taxable estate	$300,000
Add: Adjusted taxable gifts	0
Taxable amount	$300,000
Tentative tax on taxable amount	$ 87,800
Minus: Tax payable on gifts made after 1976	0
Gross estate tax	$ 87,800
Minus: Unified credit	47,000
Estate tax after unified credit	$ 40,800
Minus: State death tax credit (based on adjusted taxable estate of $240,000)	3,600
Net estate tax	$ 37,200

If Robert Jones had died in 1982, there would be no estate tax if all the property passing to the spouse qualified for the unlimited marital deduction. In this example, the taxable estate and the taxable amount would be zero.

Example 2. In 1979 Bill Smith gave his daughter a gift of property valued at $253,000. He filed a gift tax return and paid a net gift tax of $32,800 (tentative gift tax, $70,800, minus unified credit, $38,000). He had not made any prior gifts.

Bill Smith died in 1981. Because he made the gift to his daughter within 3 years of his death, the value of the gift is included in his gross estate. The estate is valued as of the date of death. The value of the gift on that date is $300,000. The gift taxes paid on the gift are also included in the gross estate. State death taxes

of $25,000 were paid by the estate. The net estate tax is computed as follows.

Gross estate	$907,800
Minus: Debts and administration expenses	107,800
Taxable estate	$800,000
Add: Adjusted taxable gifts	0
Taxable amount	$800,000
Tentative tax	$267,800
Minus: Gift taxes payable	32,800
Gross estate tax	$235,000
Minus: Unified credit	47,000
Estate tax after unified credit	$188,000
Minus: State death tax credit (based on adjusted taxable estate of $740,000)	22,800
Net estate tax	$165,200

Example 3. Assume the same facts as in Example 2, except that Bill Smith dies in 1982. His gross estate includes the gift taxes paid, but it does not include the value of the gift. However, the taxable gift is added to the taxable estate for purposes of determining the gross estate tax. The net estate tax is computed as follows.

Gross estate	$607,800
Minus: Debts and administration expenses	107,800
Taxable estate	$500,000
Add: Adjusted taxable gifts ($253,000 − $3,000)	250,000
Taxable amount	$750,000
Tentative tax	$248,300
Minus: Gift taxes payable	32,800
Gross estate tax	$215,500
Minus: Unified credit	62,800
Estate tax after unified credit	$152,700
Minus: State death tax credit (based on adjusted taxable estate of $440,000)	10,000
Net estate tax	$142,700

The above examples show how some of the ***After 1981*** changes affect the estate tax. In Example 1, the change to the unlimited marital deduction eliminated the estate tax because the surviving spouse received the property and it qualified for the deduction.

The difference in the amount of the net estate tax in Examples 2 and 3 is due to a combination of changes.

1) The value of the gift at the date of death ($300,000) is not included in the gross estate.
2) The taxable gift ($250,000) is included in the computation of the gross estate tax. The gift is included at this point in the computation because it is not included in the gross estate.
3) The state death tax credit is reduced because the gift is not included in the gross estate and therefore is not in the adjusted taxable estate.
4) The unified credit has been increased for 1982.

Estates of Nonresident Noncitizens

The entire gross estate of a decedent who, at the time of death, was not a resident or citizen of the United States, is made up in the same way as the gross estate of a U.S. citizen or resident, no matter where the property is located. However, only the part of the entire gross estate that is located in the United States is subject to the tax. Rules for determining the location of property and the different rules concerning the allowable deductions and credits for estates of nonresident noncitizens follow.

The term "U.S. resident" was defined at the beginning of this publication under *Estate Tax*. If a person is a resident of any U.S. possession and is a U.S. citizen only because of birth, residence, or citizenship in the possession, he or she is considered a nonresident noncitizen for estate tax purposes.

File Form 706NA if you are filing an estate tax return for a nonresident noncitizen.

Location of Property

Property located in the United States. For a decedent who at time of death was a nonresident noncitizen, property is considered located in the United States if it is:

1) Real property located in the United States,
2) Tangible personal property located in the United States. This includes clothing, jewelry, automobiles, furniture, or currency. Works of art imported into the United States solely for public exhibition purposes are not included,
3) A debt obligation of a citizen or resident of the United States, a domestic partnership or corporation, any estate or trust (but not a foreign estate or trust), the United States, a state, or a political subdivision of a state, or the District of Columbia (however, see the exceptions in the following paragraphs), or
4) Shares of stock issued by domestic corporations.

However, the personal effects of a nonresident noncitizen who dies while in transit through the United States are not considered located in the United States. Neither is merchandise that happens to be in transit through the United States when a nonresident noncitizen dies.

Transfers. Property that the decedent transferred before death, but that is includible in the gross estate is considered located in the United States if it is so located either at the time of the transfer or at the time of the decedent's death. These transfers include gifts made within 3 years of death (for estates of persons who died before 1982), transfers with retained life estate, transfers taking effect at death, and revocable transfers. These transfers were discussed earlier under *Gross Estate*.

Property not located in the United States. Notwithstanding the above rules, property of a nonresident noncitizen decedent is ***not*** considered located in the United States if it is:

1) A deposit with a U.S. bank, if the deposit was not connected with a U.S. trade or business and was paid or credited to the decedent's account,
2) A deposit or withdrawable account with a savings and loan association chartered and supervised under federal or state law or an amount held by an insurance company under an agreement to pay interest on it. But the deposit or amount must not be connected with a U.S. trade or business and must be paid or credited to the decedent's account,
3) A deposit with a foreign branch of a U.S. bank, if the branch is engaged in the commercial banking business,
4) A debt obligation of a domestic corporation if any interest the decedent would have received at the time of death would have been treated for income tax purposes as income from sources without the United States because less than 20% of the domestic corporation's gross income from all sources was from sources within the United States for the 3-year period (or applicable part) ending with the close of the tax year of the corporation immediately preceding the decedent's death,
5) Stock issued by a corporation that is not a domestic corporation, even if the certificate is physically located in the United States, or
6) An amount receivable as insurance on the decedent's life.

Tax conventions. The United States has concluded death tax conventions with a number of foreign countries to avoid double taxation. These conventions make credits available to estates of U.S. citizens and residents for death taxes paid to the foreign countries. In addition, they provide certain rules for determining the location of property. In some cases these rules differ from those set forth earlier. They are used to determine the credit allowable to estates of citizens and residents and to determine the property includible in the estates of nonresident noncitizen decedents who come within the scope of the conventions.

The following list shows the countries with which conventions are in force, and the nonresidents to whose estates the rules of situs in the conventions apply.

Australia—Domiciliary of Australia

Canada—Domiciliary of Canada—However, the death duty convention between the U.S. and Canada is not applicable to estates of individuals dying after 1971

Finland—Resident of Finland—Also if a beneficiary of the decedent's estate was a resident of Finland

France—Domiciliary of France

Greece—Domiciliary of Greece

Ireland—Domiciliary of Ireland

Italy—National or Domiciliary of Italy

Japan—Decedent having a beneficiary of his estate domiciled in Japan

Netherlands—Domiciliary or resident of the Netherlands

Norway—Citizen or Domiciliary of Norway

South Africa—Ordinary Resident of South Africa

Switzerland—No situs rules for purposes of imposition of tax

United Kingdom—Domiciliary of United Kingdom

Taxable Estate

The taxable estate of every nonresident noncitizen is determined by deducting from the gross estate (as discussed in the beginning of this section) the following:

Expenses, indebtedness, taxes, and losses. These items may be deducted proportionately. The deductible portion of each item is limited to the amount of each item multiplied by a fraction. The ***numerator*** is the value of the property located in the United States, and the ***denominator*** is the value of the entire gross estate, wherever located.

Transfer for public, charitable, and religious uses. The amount of all bequests, legacies, devises, or transfers, including any interest that falls into such transfers as a result of an irrevocable disclaimer made before the due date for filing the estate tax return, is deductible if the transfer is made:

1) To or for the use of the United States, any state, any political subdivision of a state, or the District of Columbia, for exclusively public purposes,
2) To or for the use of any domestic corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals. None of the net earnings of the corporation may benefit any private stockholder or individual. In addition, the corporation may not be disqualified for tax exemption because of attempting to influence legislation, and it may not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office, or
3) To a trustee or fraternal society, order, or association operating under the lodge system, but only if the contributions or gifts are to be used within the United States by the trustee or by the fraternal organization exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals. In addition, the trust or fraternal organization would not be disqualified for tax exemption because of attempting to influence legislation, and the trustee or the fraternal organization does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

The deductions are computed in the same manner as similar deductions allowed the estates of U.S. citizens or residents.

These provisions may be modified by the death tax conventions the United States has with some foreign countries.

Power of appointment. If property is includible in the decedent's estate because the decedent exercised, held, or released a power of appointment over it, and the property is given to a qualified organization, the transfer is considered a bequest by the decedent.

Death taxes payable out of bequests. If any amount of estate, succession, legacy, or inheritance taxes is payable wholly or partly out of deductible bequests, legacies, or devises, the amount deductible as a charitable deduction must be reduced by the amount of death taxes payable.

Limitation. The amount of the charitable deductions may not be more than the value of the transferred property required to be included in the gross estate.

Allowance of deductions. A deduction is allowed only if the executor discloses in the estate tax return the value of that part of the gross estate not situated in the United States.

Estate Tax Rates and Credits

The estate tax rates for the estate of a nonresident noncitizen are different from the rates used for the estate of a U.S. citizen or resident. Certain credits discussed earlier apply to these estates but may be limited.

Computation of Tax

The computation of the tax on the taxable portion of the estate of a nonresident noncitizen decedent of the United States is similar to that of decedents who are U.S. citizens or residents. An estate tax must be computed and then be reduced by certain credits.

The estate tax, before the allowance of any credits, is an amount equal to the excess, if any, of:

1) The ***tentative tax*** on the sum of—
   a) The amount of the taxable estate, and
   b) The amount of the ***adjusted taxable gifts;***

   Over:

2) The ***tentative tax*** on the amount of the adjusted taxable gifts.

The ***adjusted taxable gifts*** are the total amount of the taxable gifts made by the decedent after December 31, 1976, other than gifts includible in the decedent's gross estate. However, if the decedent was the donor of any gift, one-half of which was considered as made by the decedent's spouse and the amount of the gift is includible in the decedent's gross estate, any gift tax payable by the spouse is treated as a tax payable for a gift made by the decedent.

Compute the ***tentative tax*** according to the following tax rate schedule:

If the amount with respect to which the tentative tax is to be computed is:	The tentative tax is:
Not over $100,000	6% of the amount.
Over $100,000 but not over $500,000	$6,000, plus 12% of excess over $100,000.
Over $500,000 but not over $1,000,000	$54,000, plus 18% of excess over $500,000.
Over $1,000,000 but not over $2,000,000	$144,000, plus 24% of excess over $1,000,000.
Over $2,000,000	$384,000, plus 30% of excess over $2,000,000.

Unified Credit

A $3,600 credit against the tax is provided for the estate of a nonresident noncitizen of the United States.

However, a special rule applies if the decedent resided in a U.S. possession and was a U.S. citizen only because of birth, residence, or citizenship in the possession. The decedent is considered to be a nonresident noncitizen and the estate may qualify for a credit that is the ***greater*** of:

1) $3,600, or
2) $15,075 multiplied by the ratio that the value, at death, of the part of the decedent's gross estate that is located in the United States bears to the entire value of the decedent's gross estate.

The credit may not be more than the amount of the estate tax.

Other Credits

The credits for state death taxes, gift taxes, and the tax on prior transfers are allowable to the estates of nonresident noncitizens. If any tax that is claimed as a credit is recovered, the estate tax must be redetermined.

No credit is allowable for foreign death taxes.

The allowable credits are determined in the same manner as they are for estates of U.S. citizens and residents.

The maximum state death tax credit allowed against the gross estates of nonresident aliens is proportionate to the value of the property upon which state death taxes were paid over the total value of the gross estate for federal estate tax purposes.

For more information on these credits, see *Credits Against the Tax*, discussed earlier under *Estate Tax Computation*.

Expatriation to Avoid Tax

A special tax computation is required for the estates of certain decedent nonresident noncitizens of the United States, who lost U.S. citizenship within the 10–year period ending with the date of death. This computation applies only if a main purpose of the decedent's loss of U.S. citizenship was to avoid federal estate, gift, or income taxes.

The Internal Revenue Service must establish only that it is reasonable to believe that an individual's loss of U.S. citizenship would, but for the special tax computation discussed here, result in a substantial reduction in the estate, inheritance, legacy, and succession taxes on the transfer of the estate of the individual. Once this has been established, the burden of proving otherwise is on the executor of the estate of the decedent expatriate.

The special tax computation does not apply, however, if the loss of U.S. citizenship resulted from the application of section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended.

For the estates of decedent expatriates, subject to the special tax computation, the gross estate includes property located in the United States (discussed earlier) and certain stock in foreign corporations. These estates must use the Unified Rate Schedule used by estates of U.S. citizens and residents.

The expatriate's estate is allowed a unified credit of $13,000 against the tentative tax. This credit cannot be more than the amount of the tax liability.

The other credits allowable to the estates of nonresidents who are not U.S. citizens are allowable to the estates of expatriates.

Foreign corporation stock. In addition to property considered located in the United States under the rules discussed earlier in *Location of Property*, the value of an expatriate decedent's gross estate includes a proportionate part of the fair market value of foreign corporation stock owned by the decedent at the time of death if certain stock ownership tests are met. This part is based on the value that the foreign corporation's property having a U.S. location bears to the fair market value of all corporation property, wherever located. The ***stock ownership tests*** that must be met are as follows:

1) The decedent owned (directly or indirectly through a foreign corporation, partnership, trust, or estate) at death 10% or more of the total combined voting power of all classes of stock entitled to vote in the foreign corporation, ***and***
2) The decedent owned (directly, indirectly, or constructively) at death more than 50% of the total combined voting power of all classes of stock entitled to vote in the foreign corporation.

In determining whether the more-than-50% test has been met, stock that the decedent directly or indirectly owned, as described in (1), is added to stock that the decedent is considered

to have owned at death because of constructive ownership. (Constructive ownership is ownership attributed to the expatriate for stock held by members of the decedent's family, as well as by partnerships, trusts, estates, or corporations in which the decedent had certain interests.) Note that the same shares of stock may not be counted more than once in determining whether the more-than-50% test has been met.

Application of Pre-1967 Estate Tax Provisions

For nonresident noncitizen decedents, special rules apply if there is in effect a proclamation by the President of the United States based on findings that:

1) The foreign country of which the decedent was a resident, in connection with the transfer of estates of U.S. citizens who were ***not*** residents of the foreign country, imposes a tax that is more burdensome than that imposed under our laws on the transfer of estates of decedents who were not U.S. citizens and who ***were*** residents of the foreign country,
2) The foreign country, when requested by the United States to do so, has not acted to revise or reduce the tax imposed by it, and
3) It is in the public interest to apply pre-1967 tax provisions to the transfer of estates of decedents who were residents of the foreign country.

These special rules apply to individuals who died after the date of a Presidential proclamation. The special rules cease to apply after the date of a later Presidential proclamation providing in effect that the pre-1967 provisions are no longer to be applied to transfers of estates of nonresident noncitizen decedents who were residents of the foreign country.

At the time this publication was printed, there were no Presidential proclamations in effect.

Miscellaneous Provisions

This section discusses your duties as the executor of an estate. It includes information on paying the estate tax and determining the basis of inherited property in the hands of the beneficiaries.

Executors and Administrators

Generally, an ***executor*** is named in a decedent's will to administer the estate and distribute properties as the decedent has directed. An ***administrator*** is usually appointed by the court if no will exists, if no executor was named in the will, or if the named executor cannot or will not serve. In general, an executor and an administrator perform the same duties and have the same responsibilities.

If there is no executor or administrator appointed, qualified, and acting within the United States, the term executor includes anyone in actual or constructive possession of any property of the decedent. It includes, among others, the decedent's agents and representatives; safe-deposit companies, warehouse companies, and other custodians of property in this country; brokers holding securities of the decedent as collateral; and the debtors of the decedent who are in this country.

If you are the executor of an estate, get Publication 559, *Tax Information for Survivors, Executors, and Administrators,* for information concerning the filing of income tax returns for the decedent and for the estate.

Duties. The primary duty of the executor or administrator is to collect all the assets of the decedent, to pay the creditors, and to distribute the remaining assets to the beneficiaries. The executor is responsible for filing the estate tax return (and any income tax returns) when due and for paying the taxes determined, up to the date of discharge from duties. Additionally, the executor must keep records and supplemental data supporting the estate tax return. The prescribed forms must be used in filing the estate tax return.

If the estate of a decedent is insufficient to pay all the decedent's debts, the debts due the United States must be paid first. The decedent's federal income tax liabilities at the time of death, the estate's income tax liability, and the estate tax liability are debts due the United States. The executor of an insolvent estate is personally responsible for any tax liability of the decedent or of the estate if he or she had notice of the tax obligations or had failed to exercise due care in determining if such obligations existed before distributing the estate's assets and before being discharged from duties. The extent of such personal responsibility is the amount of any other payments made before paying the debts due the United States. The tax liabilities need not be formally assessed for the executor to be liable if he or she was aware or should have been aware of their existence.

Notice concerning fiduciary relationship. If you are appointed to act in any fiduciary capacity (as administrator, executor, or an ancillary representative) for another, you must file a written notice with the Internal Revenue Service. You may use Form 56, *Notice Concerning Fiduciary Relationship,* for this purpose. File the written notice (or Form 56) with the Internal Revenue office where the returns are filed for the person or estate for whom you are acting. You should file this notice as soon as all of the necessary information is available. It allows the Internal Revenue Service to mail to you the tax notices concerning the person or estate you represent. The notice remains in effect until you notify the appropriate Internal Revenue office that your relationship to the estate has terminated.

When you are relieved of your responsibilities as executor, you must inform the Internal Revenue office with which you filed the Form 56 that the estate has either been terminated or that your successor has been appointed. If the estate is terminated, you must furnish satisfactory evidence of that fact. Use Form 56 for the termination notice by checking the applicable box on the form and attaching the required evidence. If another has been appointed to succeed you as executor, give the name and address of your successor.

Discharge from personal liability. The executor may request a release from personal liability. Your request must specifically refer to section 2204 of the Code, or directly ask for a discharge from personal liability within 9 months. You can do this by applying in writing to the Internal Revenue Service Center for a determination of the federal estate tax and a discharge from personal liability. Within 9 months after receiving the application, the Service Center will notify you of the estate tax liability. If you apply before filing the return, the Service will notify you within 9 months after the return is filed. After you pay this amount (or this amount minus any amount for which payment has been extended) and furnish a bond (if requested by the Service Center), you will be discharged from personal liability for any deficiency in taxes later found to be due. If you do not receive a notice after the 9-month period, and you have paid the tax shown on the return, you are discharged from personal liability. In either case, the discharge is only for your personal liability as the executor. You are still liable for the payment of the federal estate tax in a fiduciary capacity out of assets included in the gross estate still in your possession.

You must furnish a personal bond if the time for paying any amount of the federal estate tax has been extended. However, see *Special Lien,* discussed later.

You may use the notice received from the Internal Revenue Service and proof of payment, such as cancelled checks or receipts, to establish that your personal liability for the estate tax has been satisfied.

Relief from personal liability for reliance on gift tax returns. If as executor you rely in good faith on gift tax returns furnished by the Internal Revenue Service for determining adjusted taxable gifts made after 1976, then you are discharged from personal liability for any estate tax deficiency attributable to ***adjusted taxable gifts*** that are:

1) Made more than 3 years before the decedent's death, and
2) Not shown on the gift tax returns.

Fiduciary other than executor. If the decedent was not a nonresident, a fiduciary other than the executor can apply for a discharge from personal liability. As a fiduciary, you should apply in writing to the Service Center for a determination of the amount of estate tax for which you may be personally liable, and for a discharge from this liability. You will be notified after the executor is discharged or after 6 months from the making of the application, whichever is later, of the amount of any tax for which you are liable. After paying this amount (other than the amount for which an extension of time to pay the tax has been granted), and upon furnishing a bond (if required), you will be discharged from personal liability for any such tax later found to be due. This does not preclude, however, the assessment and collection of any deficiency in estate tax from the fiduciary out of the assets still possessed by the fiduciary.

Special Lien

In place of the executor's personal bond, you may elect a special lien in favor of the United States. The special lien will also discharge you from being personally liable for the payment of deferred estate tax. You can do this if you elected to pay the estate tax attributable to a closely held business (including a farm) in installments. This election was discussed earlier in *Installment Payments—Closely Held Business,* under *Paying the Tax.*

This lien is considered a bond for purposes of determining your release from personal liability. If you make the special lien election, you may not substitute a bond in place of the special lien. If a personal bond has been supplied, however, you may substitute a lien under these rules for any part or all of the personal bond. You can do this by filing a proper notice of election and agreement.

Amount of lien. The amount of deferred estate taxes plus any interest and other costs attributable to the deferred amount will be the amount

of the lien. The lien is placed on real and other property designated in the lien agreement that can be expected to survive the period for payment of the tax.

The value of this lien property is its fair market value determined as of the due date for the estate tax return, reduced by other prior encumbrances, such as mortgages. If you elected the special-use valuation method for farms or other closely held businesses, the liens required by that provision also reduce the value of the property.

Additional property may have to be added to the agreement if at any time the value of the original lien property is less than the sum of the unpaid deferred taxes and the required interest amount. If additional property or other security is not furnished within 90 days after notice and demand by the Internal Revenue Service, the failure is an event that will accelerate the payment of the tax installments.

Effect of lien. For this property, the special lien replaces the regular estate tax lien. This lien and notice of the lien must be filed by the Service to be valid as against any purchaser, holder of a security interest, mechanic's lien, or judgment lien creditor. However, unlike regular tax liens, the special lien does not have to be refiled every 6 years. This lien arises when the executor is discharged from liability or, if earlier, when the notice of lien is filed. It continues until liability for the deferred amount of taxes is satisfied or becomes unenforceable by reason of lapse of time.

Even if the notice of the lien has been filed, the lien does not supersede:

1) Certain real property tax and special assessment liens,
2) Mechanic's liens for repairs or improvements to real property, or
3) Financing agreements securing loans for construction or improvement of real property, raising or harvesting of farm crops, or raising livestock or other animals, whether these security interests came into existence before or after the filing of the tax lien.

If the Internal Revenue Service files a notice that payment of the deferred amount has been accelerated, the tax liens take priority over subsequent mechanic's liens or real property construction or improvement financing agreements. But they do not take priority over real property tax or special assessment liens.

Election of lien. You may elect this lien by applying to the Internal Revenue Service office where the estate tax return was filed. Apply at any time before paying the full amount of estate tax and interest due. The application is a notice of election requesting the special lien. It must be accompanied by the agreement to lien.

Agreement to lien. Generally, a special lien arises only when everyone signs a consent agreement who has an interest in the property designated in the notice of election as property to which the lien attaches. The property does not have to be property included in the decedent's estate. The agreement is attached to the notice in which the special lien is elected. It must be in a form that is binding on all parties who have any interest in the property. It must contain the following information:

1) The decedent's name and taxpayer identification number as they appear on the estate tax return,
2) The amount of the lien,
3) The fair market value of the lien property as of the date of the decedent's death and the date of the special lien election,
4) The amount, as of the date of the decedent's death and the date of the election, of all encumbrances on the property, including mortgages and other liens in favor of the United States,
5) A clear description of the lien property and for property other than land, a statement of its estimated remaining useful life, and
6) The designation of an agent (including the agent's address) for the estate's beneficiaries and consenting parties to the lien for all dealings with the Internal Revenue Service on matters regarding the lien and the election to pay the tax in installments.

An interest in property is any interest that as of the date of the election can be asserted under local law so as to affect the disposition of any property designated in the required agreement. Any person in being at the date of the election who has any such interest in the property must enter into the agreement. This applies whether the interest is present or future, vested or contingent. Included among such persons are owners of remainder and executory interests; holders of general or special powers of appointment; beneficiaries of a gift over in default of exercise of any such power; co-tenants, joint tenants, and holders of other undivided interests when the decedent held a joint or undivided interest in the property; and trustees of trusts holding any interest in the property.

An heir is not considered a person with an interest in property just because he or she has the power under the local law to challenge (caveat) a will and thus affect disposition of the property. Similarly, creditors of an estate are not persons with an interest in property just because they are creditors.

In some cases a representative may sign the agreement for the person with an interest in property. The representative must be authorized under local law to bind the person in such an agreement. The person must want the representative to sign or be unable to enter a binding contract because he or she is too young or is incompetent.

Partial substitution of bond for lien. If the amount of unpaid estate tax plus interest exceeds the value of property listed in the agreement, the Internal Revenue Service may make the release from personal liability conditional. The release would depend upon the executor's submitting an agreement listing additional property or furnishing an acceptable bond in the amount of the excess.

Stock Redemptions to Pay Estate Taxes

Redemption of stock includible in a decedent's gross estate is exempt from dividend treatment under certain circumstances. If the redemption qualifies, the redemption is treated as an exchange. Gain is treated as capital gain if the stock was held as a capital asset at the time of the exchange.

The amount that qualifies for exchange treatment is limited to the sum of:

1) The death taxes imposed because of a decedent's death, and
2) The amount of funeral and administration expenses allowable as deductions to the estate.

The amount that qualifies for exchange treatment also includes any interest collected as a part of the death taxes imposed.

A corporation's stock will qualify for this treatment if the value of all of that corporation's stock that is included in a decedent's gross estate is more than 50% of the adjusted gross estate. The adjusted gross estate is the gross estate minus losses, debts, and funeral and administration expenses of the estate.

If stock of two or more corporations is included in the gross estate, then for purposes of the 50% requirement, the stock is treated as the stock of a single corporation. This applies if more than 75% in value of the outstanding stock of each corporation is included in the gross estate. For this purpose, if stock is community property, the surviving spouse's interest in the stock is treated as included in the gross estate.

This treatment applies to amounts distributed after the decedent's death and within the period of limitations. The period of limitations is 3 years from the date the return is filed. However, amounts distributed within 90 days after this 3-year period will qualify. Also, if the estate tax is being paid in installments, amounts received before the due date of the last installment will qualify. However, amounts distributed more than 4 years after the decedent's death will qualify for this treatment only to the extent of the lesser of:

1) The amount of the qualifying death taxes and funeral and administration expenses that are unpaid immediately before the distribution, or
2) The total of these amounts that are paid within one year after the distribution.

The exchange treatment applies to the distribution by a corporation only to the extent that the interest of a shareholder is reduced directly or through a binding obligation to contribute toward the payment of the estate's expenses or taxes.

After 1981. For the estate of a person who died after 1981, the percentage requirements are reduced. For these estates, a corporation's stock will qualify for the exchange treatment if the value of all of that corporation's stock that is included in the decedent's gross estate is ***more than 35%*** of the adjusted gross estate.

If stock of two or more corporations is included in the gross estate, then for purposes of the 35% requirement, the stock is treated as the stock of a single corporation. This applies if ***20% or more*** in value of the outstanding stock of each corporation is included in the gross estate. For this purpose, a surviving spouse's interest in stock held by the decedent and the surviving spouse as community property or as joint tenants, tenants by the entirety, or tenants in common is treated as included in the decedent's gross estate.

Reimbursement of Estate Tax

If the decedent died without a will, or if the will did not specify the bequests to use to satisfy the federal estate tax, state law will determine which assets included in the gross estate are liable. However, if the assets designated by state law are insufficient to pay the estate tax, the federal government may collect the taxes out of any assets included in the gross estate. The beneficiaries of these assets are liable to the extent of the value of the assets received, valued on the decedent's date of death. In such

a case a beneficiary may demand a reimbursement out of any part of the estate still undistributed, or a just and equitable contribution by other beneficiaries.

Liability of life insurance beneficiary. You may recover for the benefit of the estate a proportionate share of the federal estate tax from a beneficiary of life insurance proceeds on the life of the decedent and included in the gross estate, unless the decedent's will directs otherwise. However, if the surviving spouse is the beneficiary of the life insurance proceeds, only the amount in excess of the marital deduction may be recovered.

Liability of recipient of property over which decedent had power of appointment. You may recover for the benefit of the estate a proportionate share of the federal estate tax from a person who receives property that was subject to a general power of appointment and that was included in the decedent's gross estate, unless the decedent's will directs otherwise. If the surviving spouse is that person, only amounts in excess of the marital deduction reduced by life insurance proceeds for which the marital deduction was allowed may be recovered.

After 1981. You may recover for the benefit of the estate the taxes on ***certain marital deduction property*** included in the estate. The taxes may be recovered from the recipients of that property, unless the decedent's will directs otherwise. The estate tax on that property is the excess of the total estate tax paid over the total estate tax that would have been paid if the value of that property was not included in the gross estate. Any penalties and interest on the excess taxes may also be recovered. See *Certain Marital Deduction Property* discussed earlier under *Gross Estate*.

Estate Tax Lien

Generally, no tax may be assessed later than 3 years after the estate tax return is filed or is due, whichever is later. The period of assessment is 6 years if 25% or more of the value of the gross estate is not reported on the return. The period of assessment of taxes is 4 years for recipients of property included in the gross estate.

A tax lien attaches to all property included in the gross estate (except property used to pay certain administration expenses and claims) to cover the assessment. The lien is considered to attach at the decedent's date of death. It will not lapse until 10 years after that date unless the tax is fully paid or becomes unenforceable because of lapse of time. If the estate tax is not paid when due, all persons receiving this property are personally liable for the tax to the extent of the value of the property on the date of the decedent's death.

This general estate tax lien does not attach to any property that is subject to a special lien. A special lien attaches to property for which the special-use valuation method is used, or for which the estate tax is paid in installments.

A federal tax lien generally takes priority over certain interests in property held by purchasers, holders of a security interest, mechanics lienors, and judgment lien creditors, but only if notice of the tax lien is appropriately filed.

However, the estate tax lien does not have to be filed. The above mentioned parties are protected from the estate tax lien in certain situations.

Basis—Property Acquired from a Decedent

Generally, the basis of property in the hands of a person who acquired it from a decedent (or to whom the property passed from a decedent) is the value used for estate tax purposes. The property could have been valued in the following ways:

1) The fair market value at the date of the decedent's death,
2) The fair market value determined on the alternate valuation date (discussed earlier), if so elected by the executor, or
3) The special-use valuation for real property used in farming or other closely held business (discussed earlier), if so elected.

After 1981. The basis in certain appreciated property that a beneficiary acquires from a person who died after 1981 may be the decedent's adjusted basis in the property immediately before death rather than its fair market value. This applies only if after August 13, 1981, the beneficiary or the beneficiary's spouse had given the decedent the appreciated property as a gift during the one-year period ending on the date of death. Appreciated property is any property whose fair market value on the day it was given to the decedent is more than its adjusted basis.

If the special-use valuation (item (3) above) was used for property that a beneficiary received from an estate of a person who died after 1981, the beneficiary's basis in the property can be increased if it becomes subject to the additional estate tax, as discussed earlier under *Dispositions and Failures to Use for Qualified Use*. To qualify for the increase, the beneficiary must make an irrevocable election, and pay the interest on the additional estate tax figured for the period from the date 9 months after the decedent's death until the due date for paying the additional estate tax. If these requirements are met, the beneficiary's basis is increased to the fair market value of the property on the date of the decedent's death or the alternate valuation date.

Internal Revenue Service Explanation of Valuation

The Internal Revenue Service may value any item of property for the purposes of the estate or gift tax or the generation-skipping tax. If so, the executor or donor may request that the Internal Revenue Service furnish a written statement explaining the valuation, including a copy of any expert appraisal made for the Service.

The request must be filed within the period of limitations for filing a claim for refund. This is usually 3 years from the date the return is filed. The request is filed with the district director's office that has jurisdiction over the return.

Gift Tax

This section discusses the federal gift tax provisions that apply to gifts made after 1981. If you have a question on a gift made before 1982, read the general provisions and those that are identified by the phrase **Before 1982.**

The federal gift tax is imposed on the gratuitous transfer of property. The person making the gift (the donor) must generally pay the tax. If the donor does not pay the gift tax, the person receiving the gift (the donee) may have to pay the tax.

Whether a person is subject to a gift tax may depend on whether the person is a citizen or resident of the United States. A person who is not a U.S. citizen or resident is subject to gift tax only on gifts of property situated in the United States.

Citizens or residents of the United States. Federal gift tax applies to all transfers by gift of property, wherever situated, by U.S. citizens or residents. The term ***United States*** includes only the 50 states and the District of Columbia. It does not include U.S. possessions or territories. For this purpose, a U.S. resident is a noncitizen domiciled in the United States at the time of the gift. A person acquires a domicile by living in a place, even for a brief period of time, with no definite present intention of leaving permanently.

A gift by a corporation is considered a gift by its individual stockholders. A gift to a corporation generally is considered a gift to its individual stockholders. However, in certain cases, a gift made to a charitable, public, political, or similar organization may be considered a gift to the organization.

Nonresident noncitizen. For an individual who is neither a citizen nor a resident of the United States, the federal gift tax applies only to gifts of property situated within the United States. If an individual is a resident of a U.S. possession at the time of the gift and is a U.S. citizen only because of birth, residence, or citizenship in that possession, he or she is considered a nonresident noncitizen for gift tax purposes. A gift of intangible personal property is not subject to federal gift tax if it is made by a nonresident noncitizen, except in the case of certain expatriate U.S. citizens. (See *Gifts by Nonresident Noncitizens.*)

The Gift Tax Return

Filing the Return

If after 1981 you make a transfer by gift during a calendar year, file Form 709, *United States Gift Tax Return*, for that year. However, you do not have to file a return for:

1) A transfer that is not more than the annual exclusion,
2) A qualified transfer for educational or medical expenses, or
3) A transfer to your spouse that qualifies for the unlimited marital deduction.

These items are discussed later under *Taxable Gifts.*

Form 709 is filed annually. You must file it by April 15 of the year after the year you made the gift, unless you have received an extension of time for filing the return. See *Extension of time to file*, later.

If the donor of the gift died during the year in which the gift was made, the gift tax return is due not later than the earlier of the due date (including extensions) for the donor's estate tax return or April 15. Therefore, the gift tax return may be due before April 15.

Before 1982. If you made a gift before 1982, you had to file a gift tax return on a quarterly basis. Special filing requirements applied if the total amount of taxable gifts during a quarter was $25,000 or less. For more information on the filing requirements for gifts made before 1982, see Form 709, *United States Quarterly Gift Tax Return*, for the year in which you made the gift.

Where to file. File Form 709 with the Internal Revenue Service Center serving the state in which your legal residence or principal place of business is located. If you have no legal residence or principal place of business in the United States, file the return with the Internal Revenue Service Center, Philadelphia, PA 19255.

Other documents. You must submit certain documents with the return. Submit copies of instruments executed for transfers of property, statements by insurance companies on Form 712, *Life Insurance Statement*, for every insurance policy listed on the return, and copies of appraisals of real property. If you list shares of stock in closely held corporations on the return, attach the documents you use to value the shares, such as balance sheets, profit and loss statements for each of the 5 years preceding the valuation date, and statements of dividends paid during that period.

Penalties are provided for willful failure to file a return on time and for willful attempt to evade or defeat payment of the tax.

Form 709-A, *United States Short Form Gift Tax Return* may be filed if you meet certain requirements and you and your spouse consent to ***gift splitting***. See *Gift Splitting* discussed later.

Who may file. You can use Form 709-A if all of the following requirements are met:

1) You are a U.S. citizen or resident, and were married during the entire calendar year to one individual who is a U.S. citizen or resident. Both spouses must have been alive at the end of the calendar year.
2) Your only gifts, other than qualified transfers (discussed under *Taxable Gifts*), to a third party consisted entirely of present interests in tangible personal property, cash, or stocks and bonds listed on a stock exchange.
3) Your total gifts (other than qualified transfers) to each third-party donee are not more than $20,000 ($6,000 for 1981) for the calendar year.
4) You did not make any gifts of terminable interests to your spouse during the calendar year.
5) Your spouse did not make any gifts during the calendar year to any of the donees listed on this form, did not make gifts of terminable interests to you, did not make gifts (other than qualified transfers) of over $10,000 to any other donee or make any gifts of a future interest.
6) Your spouse agrees to split with you all of the gifts you made during the calendar year.
7) You did not file a Form 709 for this calendar year.

Note. For gifts made in 1981, there could not be any gifts between spouses of more than $3,000 or of a future interest.

When to file. File Form 709-A by April 15 of the calendar year following the year you made the nontaxable split gifts, unless an extension of time to file has been granted.

Extension of time to file. An extension of time to file a gift tax return (up to 6 months) may be requested from the District Director or Service Center for the donor's area. The reason for the delay must be fully explained. An extension of time to file does not extend the time to pay the tax. No form is provided for this request.

An extension of time to file an ***income tax return*** for any tax year that is a calendar year automatically extends the time for filing the annual gift tax return for that calendar year.

Paying the Tax

The tax shown on the gift tax return must be paid by the person required to file the return at the time and place fixed for filing.

Extension of time to pay. At the request of the donor, a reasonable extension of time, up to 6 months, may be granted by the Service Center for the payment of the tax shown on the return. The extension may exceed 6 months if the donor is abroad.

For a deficiency, an extension of time for up to 18 months may be granted. In an exceptional situation another 12 months may be granted.

Interest must be paid on any amount of tax that is not paid by the last date prescribed for the payment of the tax.

Penalty. A penalty of one-half percent per month of the unpaid balance, up to 25%, will be charged on the failure to pay, unless reasonable cause can be shown.

Gifts in General

The gift tax applies to a transfer by gift of real or personal property. The property may be tangible or intangible. The gift may be direct, indirect, or given in trust. In other words, all transactions in which property or property interests are transferred to another without adequate consideration constitute gifts subject to gift tax.

However, transfers of money or other property to a qualified political organization (including a newsletter fund) for use by the organization are not subject to gift tax.

The tax may apply to transfers made for valuable consideration if the value of the property transferred is more than the consideration received. In that case, the tax is imposed only on the value of the excess. However, if a bona fide transfer, sale, or exchange is made at arm's length in the ordinary course of business, the transaction will be considered a transfer for adequate consideration and not subject to gift tax.

A consideration that is not reducible to a value in money or money's worth, such as love and affection, or a promise of marriage, must be considered totally gratuitous. The giving up (or promise to give up) of dower or curtesy, or of other marital rights in a spouse's property or estate, is not considered to any extent a consideration "in money or money's worth." If property is transferred in exchange for the release

of such rights, the property is a gift for gift tax purposes. However, see *Certain Property Settlements*, for an explanation of transfers of property in the event of an actual divorce and a written agreement.

If a gift is made on the express or implied condition that the donee pay the gift tax, the payment of this tax is deducted from the value of the gift made as partial consideration for the gift. It should be noted that such an agreement does not release the donor from the principal liability of paying the gift tax, if in fact the tax is not paid. The payment of gift taxes by a donee causes an interrelated computation known as a ***net gift computation.*** This computation is explained in Publication 904, *Interrelated Computations for Estate and Gift Taxes*.

There are many ways to make a gift. Examples of some transfers that come within the scope of the gift tax law follow.

Example 1. Bob Green creates a trust under the terms of which his child is to get income for life and his grandchild the remainder at the child's death. Gifts of the income to the child and of the remainder to the grandchild result from the transaction.

Example 2. Ann Gray, with personal funds, buys real property and has title conveyed to herself and her brother, Ned, as joint tenants with right of survivorship. A gift has been made to Ned.

Example 3. Jack White, with his own funds, creates a joint bank account for himself and his brother, Tom. There is a gift when Tom draws money out of the account for his own benefit. If both had contributed money to the account, there would be a gift by one to the other only to the extent that the amount withdrawn by the other person exceeds his own contribution.

Example 4. Jay Brown, with his own funds, purchases a U.S. savings bond registered as payable to himself and his wife, Jan. There is a gift to Jan when she surrenders the bond for cash for her own benefit.

Certain types of transfers are subject to special tax rules. They are discussed later in *Particular Types of Gifts*.

Completed gift. The gift tax is not imposed on the receipt of gift property, but rather upon the donor's act of making a completed gift. A gift is complete if a donor has ***parted with dominion and control*** over the transferred property or property interest, leaving the donor without the power to change its disposition, whether for the benefit of the donor or for the benefit of others.

A promise to make a gift becomes taxable in the year the obligation becomes binding and not when the discharging payments are made. As a result, if one promises to transfer property in the future, the gift becomes taxable as of the first date on which it is possible to determine that the transfer must be made and that it will be of a determinable amount.

Example 1. If you create a trust under the terms of which you can revoke the transfer and revest title in your name, the transfer is an incomplete gift. The same would be true if you reserved the power to alter the instrument, enabling you to name new beneficiaries or change the interests of the beneficiaries. The gift would, in either case, become complete at such time as you renounce the power, or the right to exercise it ceases, because of some event or contingency or the fulfillment of some condition other than your death. The gift would be considered complete if the powers could be exercised only with the consent of a person having a substantial adverse interest.

Example 2. William Cedar creates a trust giving income for life to his wife and providing that, at her death, the corpus will be distributed to their son, Jack. William reserves the right to revoke the transfer but only with the consent of Jack, in which event the corpus would revert to William. The gift is considered complete in its entirety, because Jack has a substantial adverse interest in the property.

Example 3. If Susan Gray delivers a properly endorsed stock certificate to George Black or to George's agent, the gift is completed, for gift tax purposes, on the date of delivery. If Susan delivers the certificate to her bank or broker as her agent, or to the issuing corporation or its transfer agent, for transfer to George's name, the gift is completed on the date the stock is transferred on the corporation's books.

Example 4. If you deliver your own check or note to another as a gift, the gift is not complete, for gift tax purposes, until the check or note is paid or is transferred for value to a third person.

Particular Types of Gifts

There are some kinds of gifts for which special gift tax rules apply.

Powers of Appointment

The exercise or complete release of a general power of appointment is treated as a gift unless the exercise or release was for adequate consideration. There are different rules for powers of appointment created before October 22, 1942. They are discussed later.

A power of appointment is a power to determine who will own or enjoy the property subject to the power. It must be created by someone other than the possessor (holder) of the power. It does not include a power retained by the holder on property he or she transfers. The term includes all powers that are, in substance and effect, powers of appointment regardless of what they are called and regardless of local property law.

Some powers are not powers of appointment. A power to amend only administrative provisions of a trust that do not substantially affect the beneficial enjoyment of the trust property or income would not be considered a power of appointment. A power to manage, invest, or control assets, or to allocate receipts and disbursements, when exercised only in a fiduciary capacity, would not be considered a power of appointment.

General powers of appointment are those in which the holders of the powers can appoint the property subject to the power to themselves, their creditors, their estates, or the creditors of their estates. They include the unlimited power to consume, invade, or appropriate either income or corpus, or both, for the benefit of the holder of the power.

Powers of appointment are not general powers if, by their terms, they are exercisable only for the benefit of one or more persons or classes other than the holders, their creditors, their estates, or the creditors of their estates, or expressly are not exercisable in favor of the holders, their creditors, their estates, or the creditors of their estates.

An individual who has both a lifetime income interest in a trust as well as a nongeneral power to appoint the underlying property to another, has two separate rights. If the individual exercises the power during life, a taxable gift results, because by exercising that power he or she also gives up the income interest. The value of the gift is the amount of the income interest subject to the individual's power at the time of the transfer. The release of the power itself does not result in a taxable gift.

A power limited by an ascertainable standard relating to the holder's health, education, support, or maintenance, is not a general power of appointment. However, a power to use property for the holder's comfort, welfare, or happiness is ***not*** considered an ascertainable standard.

Joint powers. If a power of appointment can be exercised by the holder, but only with the consent of the creator of the power, or a person having a substantial adverse interest in the property subject to the power, the holder is ***not*** considered to have a general power of appointment. For this purpose, a trustee administering a trust in a fiduciary capacity does not, by that fact alone, have an adverse interest in the trust.

Exercise or release. If the holder of a general power of appointment exercises or releases the power, he or she will have made a gift. A release of a power need not be formal in character.

Lapses. The failure to exercise a general power of appointment within a specified time, so that the power lapses, constitutes a release of the power. However, the lapse is treated as a release only to the extent that the value of the property that could have been appointed by the exercise of the lapsed power exceeds the greater of either $5,000, or 5% of the total value of the property out of which the appointment could have been satisfied.

Disclaimer. A qualified disclaimer or renunciation of a general power of appointment is not considered a release of the power and does not result in a gift. A disclaimer is a complete refusal to accept the power of appointment. There can be no disclaimer of a power after it has once been accepted.

If the power was created in the person disclaiming before January 1, 1977, the disclaimer must meet the requirements of local law. A disclaimer of a power of appointment, created after 1976, must meet the requirements for a qualified disclaimer. See *Qualified Disclaimers* discussed later.

Power created before October 22, 1942. A gift results if a general power of appointment created before October 22, 1942, is exercised. The release or lapse of such a power does not result in a gift. Also, a power created before October 22, 1942, that is only exercisable by the holder together with another person, regardless of adverse interest, is not treated as a general power of appointment.

Time of creation of power. A power of appointment created by will generally is considered as created on the date of the creator's death. However, a power of appointment created by a will executed before October 22, 1942, is considered as created before that date if the creator died before July 1, 1949, without having republished the will after October 21, 1942. A power of appointment created by an inter vivos instrument is considered as created on the date the

instrument takes effect. Such power is not considered as created at some future date merely because it is not exercisable immediately, or because it is revocable, or because the identity of its holders is not ascertainable until after the date the instrument takes effect. However, if the holder of a power exercises it by creating a second power, the second power is considered as created at the time of the exercise of the first.

Qualified Disclaimers

For the purpose of the estate, gift, and generation-skipping transfer taxes, if a person makes a qualified disclaimer with respect to any interest in property, the property will be treated as if it had never been transferred to that person. Accordingly, the disclaimant is not regarded as making a gift to the person who receives the property because of the qualified disclaimer.

Generally, local law determines whether a disclaimer is a qualified disclaimer. If a disclaimer, under local law, does not allow the person disclaiming the property to rid himself or herself of the property's ownership, and transfer its ownership to another person, it is not a qualified disclaimer. However, a person disclaiming property is not considered as accepting property, merely because under local law title to the property transfers to the person disclaiming the property at the death of a decedent. See *Certain transfers treated as disclaimers* for transfers that do not have to meet local law provisions.

Requirements. To be a qualified disclaimer, a refusal to accept an interest in property must meet the following conditions:

1) The refusal must be in writing,
2) The refusal must be received by the transferor of the interest, the legal representative of the transferor, or the holder of the legal title to the property to which the interest relates within 9 months after the later of—
   a) The day on which the transfer creating the interest is made, or
   b) The day on which the disclaimant reaches age 21,
3) The disclaimant must not have accepted the interest or any of its benefits,
4) As a result of the refusal, the interest must pass without any direction from the disclaimant to either—
   a) The spouse of the decedent, or
   b) A person other than the disclaimant, and
5) The refusal must be irrevocable and unqualified.

The 9-month period. The 9-month period for making a disclaimer generally is determined for each taxable transfer. For lifetime transfers the period begins on the date the transfer is a completed transfer for gift tax purposes. For a transfer by will it begins on the date of the decedent's death.

For a general power of appointment the person who would be the holder of the power has 9 months after the creation of the power to disclaim; the person to whom property passes by reason of the exercise or lapse of a general power may disclaim within a 9-month period after the exercise or lapse. When a lifetime transfer is included in the transferor's gross estate because the transferor retained an interest in the property, the person who received the interests in the property during the lifetime of the grantor and a person who would receive an interest in the property on or after the grantor's death has 9 months after the taxable transfer in which to disclaim.

A qualified disclaimer may be made for an undivided portion of an interest. A power with respect to property is treated as an interest in that property.

Certain transfers treated as disclaimers. If you receive an interest in property because of a transfer made ***after 1981***, your transfer of that interest may be treated as a qualified disclaimer. To qualify, you must make a written transfer of your entire interest in the property. The transfer must be received within the 9-month period after the later of the date on which the transfer creating the interest in such person was made, or the day on which such person attains age 21. The interest must be transferred to a person or persons who would have received the property had you made a qualified disclaimer as discussed above.

Your direction of the transfer to these persons is not considered your acceptance of the property. The persons who may receive the interest are determined by local law. However, the transfer does not have to satisfy the local disclaimer statutes.

Before 1982. If you receive an interest in property because of a transfer made before 1982, you do not qualify to treat a transfer of that interest as a disclaimer under the written transfer treatment discussed above. You must meet the requirements of a qualified disclaimer by making a written refusal of the interest. The disclaimer must be effective under local law to be treated as a qualified disclaimer.

Tenancies by the Entirety

Before 1982. The following discussion applies only to gifts made before 1982. There is no gift tax on transfers created by tenancies by the entirety after 1981.

Tenancies by the entirety in real property. A tenancy by the entirety is essentially a joint interest in real property between husband and wife with the right of survivorship or a tenancy that gives them similar rights, regardless of terminology.

If a tenancy by the entirety was created, a gift is considered to have occurred either at the time of the creation of the tenancy or at the time of the termination of the tenancy. A gift was considered to have occurred at the creation of a tenancy by the entirety in real property only if the contributing spouse elected to treat the transaction as a gift in that quarter.

Election. To make the election, you had to file a gift tax return for the quarter in which the transaction occurred, even if the value of the gift did not exceed the annual exclusion ($3,000 for 1981).

If you make this election, the interest of each spouse is treated as half of the total joint interest. The election applied to each addition to the value of the tenancy and the interest of each spouse is treated as half of the value of the total joint interest regardless of the amount contributed.

Termination. If you did not make the election, no gift resulted at the time the tenancy was created. However, a gift resulted at the termination of the tenancy if the proceeds received by one of the spouses was larger than the proceeds allocable to the consideration furnished (including additions) by that spouse to the tenancy. This did not apply if termination was because of the death of a spouse.

When a completed gift occurred, either at the creation or termination of the tenancy by the entirety, the gift tax marital deduction applied. See *Marital Deduction*, discussed later.

Tenancies by the entirety in personal property. The retained interest of each spouse was treated as half of their joint interest in:

1) A creation (by one spouse alone or by both spouses) of a joint interest of a husband and wife in personal property with right of survivorship, or
2) Any additions to the value of the personal property, such as improvements and reductions in indebtedness on the property.

Exception. Actuarial computations are required for any joint interest in personal property, if the fair market value of the interest or of the property (determined as if each spouse had a right to sever) cannot reasonably be ascertained except by reference to the life expectancy of one or both spouses. For example, the amount of a gift involving a joint and survivor annuity would require an actuarial computation.

Qualified joint interests. Interests created by a husband and wife after 1976 and before 1982 may be qualified joint interests. If they qualify they receive special treatment for estate tax purposes. See *Joint Interests*, in the *Estate Tax* section of this publication.

Certain Property Settlements

Transfers of property or property interests made under the terms of a written agreement between spouses in settlement of their marital or property rights are considered to be for adequate consideration in money or money's worth and, therefore, are exempt from the gift tax (whether or not the agreement is approved by a divorce decree), if the spouses get a final decree of divorce within 2 years after entering into the agreement. Transfers to provide a reasonable allowance for the support of minor children (including legally adopted children) of a marriage are not subject to the gift tax if made under an agreement that satisfies these requirements.

If a husband and wife have a written property settlement, and a final decree of divorce is not granted by the due date for filing a gift tax return for the calendar year in which the settlement becomes effective, the transferor must show the transfer on a gift tax return for that calendar year. Attach a copy of the settlement agreement to the return. Send a certified copy of the final divorce decree to the Internal Revenue office where you filed the gift tax return not later than 60 days after the divorce is granted. Until the Service receives evidence that the final decree of divorce has been granted (but no more than 2 years from the effective date of the settlement), the transfer will tentatively be treated as made for an adequate consideration in money or money's worth.

Support rights. A release of support rights constitutes a consideration in money or money's worth. However, a transfer in settlement of dower or curtesy inheritance rights is not reducible to money and results in a gift. Therefore, the transfer of property under a property settlement agreement incident to a legal separation results in a gift ***only*** to the extent that the value of the transferred property is more than the value of any support rights surrendered.

Voluntary increases in support payments after a final decree of divorce are subject to the gift tax if, under state laws, the court has no authority to modify the decree as it pertains to the payments. The value of the gift is the amount by which each payment exceeds the amount specified in the original written agreement between the spouses.

The facts in the following example are applied in three situations to illustrate the gift tax consequences of an individual's transfer of property to a trust, under an agreement in contemplation of divorce and in exchange for the spouse's surrender of support rights.

Example. John and Mary Brown entered into a written agreement in contemplation of a divorce. Except as specified in each situation, the agreement contained a provision that, in exchange for Mary's surrender of the right to support, John would transfer $100,000 to a trust upon the issuance of a divorce decree.

At the time of the agreement, John and Mary had two adult children. The divorce occurred more than 2 years after the agreement was signed, and the divorce decree was issued by a court that had no power to alter or invalidate the agreement.

Situation 1. Under the terms of the trust, the income is payable to Mary for life, and at Mary's death the principal is payable to the children of John and Mary. Since their children are adults, John and Mary have no legal obligation to support them. When John made the transfer to the trust, the present value of Mary's right of support was $50,000. The present value of the right to trust income for Mary's life is $60,000 as of the transfer date. The present value of the remainder is $40,000.

Gift tax consequences. Since the value of the trust income interest transferred by John is more than the value of the support rights surrendered by Mary, John's gifts for federal gift tax purposes are:

1) $10,000 to Mary (the excess of the value of Mary's income interest ($60,000) over her support rights ($50,000)), and
2) $40,000 to John and Mary's children (the full value of the remainder interest).

Situation 2. Under the terms of the trust, one-third of the trust income is payable to one of John and Mary's children, and two-thirds of the income is payable to Mary. At Mary's death, all income payments stop and the trust principal is paid to both children. John and Mary have no legal obligation to support their adult children. The present value of the one child's right to trust income is $20,000 and the present value of Mary's right is $40,000. The present value of Mary's right of support is $50,000. The present value of the remainder is $40,000.

In the settlement agreement, John agreed to provide one child with the one-third income interest after Mary bargained for an income interest of less value than she might otherwise have demanded, in view of her support rights, to secure the income payments for their child.

Gift tax consequences. Mary bargained for a reduced income interest to secure an income interest in the trust for the child. Therefore, the excess ($10,000) of the value of Mary's support rights ($50,000) over Mary's income interest ($40,000) is excludable from the value of the child's income interest ($20,000) as consideration in money or money's worth. The amount of John's gift to the child is the excess of the income interest transferred to the child over the value of the consideration received by John, or $10,000.

Since Mary transferred the excess value ($10,000) of her support rights to secure the income interest to the child, Mary has made a taxable gift to the child of $10,000.

The gift tax is also applicable to the full value of the remainder interest ($40,000) transferred by John to the children.

Situation 3. Under the terms of the trust, the income is payable to Mary for life and at Mary's death the trust terminates, and the remaining trust principal is payable to John's brother, Fred.

The present value of Mary's income interest is $60,000. The present value of the remainder interest is $40,000. The value of Mary's surrendered right to support is $70,000.

Mary neither suggested nor was concerned with naming the person who would receive the remainder of the trust principal after her death. Mary's main concern was to avoid any litigation or other delays; thus, she settled for a monthly payment that was smaller than the amount she would have received if she had demanded and been paid the full value of the support she was entitled to.

Gift tax consequences. The transfer of the income interest to Mary was adequately met by valuable consideration; thus, no gift was paid to Mary. However, the amount of the gift of the remainder interest from John to his brother Fred is its full present value of $40,000 on the date of the gift.

Although John obtained a release by Mary of support rights that was more than the income interest transferred to her, the excess value was not paid to secure the transfer of the remaining interest to Fred. Therefore, no amount is excludable as consideration in money or money's worth from the value of the remainder interest transferred by John to his brother.

However, the value of the support rights ($70,000) Mary surrendered exceeded the income interest ($60,000) transferred to Mary by $10,000. Her motives for releasing the excess value of the support rights (to avoid litigation and delay) are not consideration for purposes of the gift tax. Therefore, Mary has made a taxable gift to John of $10,000.

Survivor Annuities

A gift generally results when an employee who has an unqualified right to an annuity elects to receive a lesser amount so that at the employee's death a survivor annuity will be paid to the employee's designated beneficiary. The gift is made in the calendar year in which the employee gives up the power to deprive the beneficiary of the survivor annuity by making the election irrevocable.

Excluded from gift tax. If an election or option and the annuity are part of a ***qualified plan*** or an ***individual retirement arrangement,*** the value of all or part of a survivor annuity may not be subject to the gift tax. If the plan is qualified, only that part of the annuity that is attributable to the employee's contributions to the plan is subject to the gift tax when the election or option is exercised. The part of the annuity attributable to the employer's contributions to the plan is not subject to the gift tax.

Contributions by, or on behalf of, a self-employed person under a qualified retirement plan are considered ***contributions by an employer*** to the extent that the contributions were deductible for income tax purposes. A ***deductible employee contribution*** is considered made by an employer. These contributions are qualified voluntary employee contributions that were made after 1981 and that were an allowable income tax deduction.

All or part of the value of the survivor annuity from the following qualified plans or individual retirement arrangements is excluded from the gift tax:

1) An employee's trust forming part of a qualified pension, stock bonus, or profit sharing plan,
2) An annuity contract purchased by an employer under a qualified annuity plan,
3) An annuity contract purchased for an employee by certain tax-exempt organizations or public schools,
4) The Retired Serviceman's Family Protection Plan or Survivor Benefit Plan,
5) A bond purchase plan, or
6) An individual retirement account, annuity, or bond.

No exclusion from the gift tax is allowable to the extent that the employee's interest in a qualified noncontributory profit-sharing plan has been made available to the employee before the exercise of the election or option, without any significant penalty or restriction on the exercise of his or her right to obtain full possession of that interest.

Community property. In most community property states, a spouse is considered to have a one-half interest in the earnings and accumulated benefits attributable to payments on an annuity of his or her spouse. Therefore, the surviving spouse is considered to have made a gift of one-half of any earnings and benefits as a result of a deceased spouse's death when these benefits are payable to other beneficiaries.

However, the value of the surviving spouse's interest in the deceased spouse's earnings and benefits is not considered a gift by the surviving spouse to other beneficiaries to the extent:

1) The interest is attributable to employer contributions or contributions to an individual retirement arrangement, and
2) The interest arose solely as an interest in community income under a state's community property laws.

Certain Marital Deduction Property

Your spouse may elect the marital deduction for a transfer of certain qualified terminable interest property to you. You also may receive qualified terminable interest property from your spouse's estate. Qualified terminable interest property is property in which you have received a qualifying income interest for life. (See *Marital Deduction* under *Taxable Gifts*, or *Marital Deduction* in the *Estate Tax* section of this publication, for a complete discussion.)

If you dispose of all or part of a qualifying income interest for life in any qualified terminable interest property for which your spouse or your spouse's estate has been allowed a marital deduction, you have made a transfer of the property that is subject to the gift tax. Disposition can be by sale, gift, or otherwise. The amount of the gift is the entire value of the property less any amounts received on disposition. If you did not dispose of any part of this property during your life, the value of the property is included in your gross estate. (See *Certain Marital Deduc-*

tion Property in the *Estate Tax* section of this publication.)

Gift tax recovered. If you pay a gift tax because of a transfer of this marital deduction property, you may recover the gift tax on the property from whoever receives the property. The gift tax on this property is the excess of the total gift tax paid over the total gift tax that would have been paid if the value of the property had not been included in taxable gifts. You may also recover any penalties and interest on the excess taxes.

Before 1982. These provisions apply only after 1981. Your spouse could not elect qualified terminable interest treatment before 1982.

Valuation

The value of a gift is the ***fair market value*** of the property on the date the gift is made. There is no alternate valuation date for the federal gift tax as there is for the federal estate tax.

The ***fair market value*** is the price at which the property would change hands between a willing buyer and a willing seller, when neither one is under any compulsion to buy or to sell, and when both have reasonable knowledge of all relevant facts. Fair market value may not be determined by a forced sale price, nor by the sale price of the item in a market other than that in which that item is most commonly sold to the public.

Thus, in the case of an item that is generally sold at retail, the fair market value is the price at which the item or a comparable item would be sold.

Example. Automobiles are usually retailed so the fair market value would be the retail value. The price a used car dealer would pay may not be used. If tangible personal property is sold through classified advertising in a newspaper, and if this is a common way of selling this kind of property, the selling price will be considered the retail sales price of the item at the time of the sale. This also applies to property sold at a public auction. This retail sales price also will be considered the retail sales price of the item on the date of the gift if the sale is made within a reasonable period following the gift and there is no substantial change in market conditions or other circumstances affecting the value of similar items between the time of the sale and the date of the gift.

Gift tax paid by donee. If a gift is made on the express or implied condition that the donee pay the gift tax, the amount of this tax may be deducted from the value of the gift made as partial consideration for the gift. This kind of agreement does not release the donor from the principal liability of paying the gift tax, if in fact the tax is not paid. The donor's available unified credit must be used to reduce the tax liability of the donee. The value of the gift is reduced only by the amount of tax liability assumed by the donee.

When a gift is made jointly (split) by a husband and wife who are in different gift tax brackets with the condition that the gift tax is to be paid by the donee or out of the property itself, a special formula is used to compute the gift tax that is deducted in order to value the gift. This formula may be found in Publication 904.

The payment of gift taxes by a donee causes an ***interrelated computation*** known as a net gift computation. This computation is explained in Publication 904.

Special rules. There are special rules for determining the fair market value of some kinds of property, such as stocks and bonds, shares of mutual funds, interests in a business, annuities, life insurance, life estates, terms for years, remainders, and reversions. These rules are generally the same as those for the determination of fair market value for federal estate tax purposes and are discussed in detail in *Valuation*, under *Estate Tax*.

Gift by Husband or Wife to Third Party—Gift Splitting

A gift made by a person to someone other than a spouse may be considered as made one-half by each spouse. This is known as ***gift splitting*** and both spouses must consent to its use. Generally, if a gift is split a lower gift tax rate bracket applies to the total taxable gift. In addition, the annual exclusion and the unified credit allowable to each spouse applies to the gift.

To split the gift the spouses must be legally married to each other at the time of the gift. If they are divorced during the year, they still may split the gift so long as neither marries anyone else during that year. In addition, both must be citizens or residents of the United States on the date of the gift and one spouse may not create a general power of appointment in the other spouse over the property transferred. If the spouses consent to gift splitting, all gifts made during the year that qualify must be split.

Generally, in community property states the election is not available to spouses who make gifts of community property because both spouses are already considered to own the gift property equally.

Consent. If a gift is to be split, both spouses must indicate their consent on the gift tax return. If both spouses file gift tax returns within the time for signifying consent, it is sufficient if:

1) The consent of the husband is signified on the wife's return and the consent of the wife on the husband's return,
2) The consent of each spouse is signified on his or her own return, or
3) The consent of both spouses is signified on one of the returns.

Under certain circumstances, only the spouse making the actual gift has to file a return on which the other must indicate consent. You may use Form 709-A, discussed earlier, if you meet the requirements for that form.

The consent to split gifts cannot be made after a gift tax return has been filed and the due date for filing the return has passed. The consent may be revoked, but not after April 15 of the year following the year of the gift.

Taxable Gifts

Determine the amount of your taxable gifts by subtracting from your total gifts for the year the annual exclusion, the charitable deduction, and the marital deduction. Your total gifts for the year do not include a qualified transfer.

Qualified transfer. A qualified transfer is any amount paid for an individual:

1) To an educational organization as tuition for the individual's education or training, or
2) To any person for medical care provided to the individual.

The exclusion for a qualified transfer is in addition to the annual exclusion. Therefore, if only part of a payment was a qualified transfer, the other part could qualify for the annual exclusion. A qualified transfer is allowed without regard to the relationship between the donor and the donee.

An educational organization is an organization with a regular faculty and curriculum and a regularly enrolled body of students in attendance at the place where the educational activities are carried on. The individual may be a full- or part-time student. The payment must be made directly to the organization. The qualified transfer is limited to direct tuition costs. It does not apply to books, supplies, dormitory fees, etc.

The payment for medical care must be made directly to the person or organization providing the medical services. Reimbursement to the individual for expenses he or she paid and amounts reimbursed by insurance do not qualify.

Before 1982. The exclusion for qualified transfers did not apply to transfers made before 1982. If you made a transfer as described above, you may have made a gift that had to be reported on a gift tax return.

Annual Exclusion

Generally, the first $10,000 of gifts made to any one person during any calendar year (except gifts of future interests in property) is excluded in determining the total amount of gifts for the calendar year. This annual exclusion is applied to all gifts of a present interest made during the calendar year. For a gift in trust, each beneficiary of the trust is treated as a separate person for purposes of the annual exclusion. However, the exclusion is not available for gifts of a future interest, such as a remainder interest in a trust. The entire value of such a gift must be included in the total amount of gifts for the calendar year in which the gift was made.

The annual exclusion allows spouses who consent to split their gifts to transfer up to $20,000 to any one person during any calendar year without any gift tax liability, if the gift qualifies as a present interest.

Future interests is a legal term that includes reversions, remainders, and other interests or estates that are to commence in use, possession, or enjoyment at some future date. On the other hand, an unrestricted right to the immediate use, possession, or enjoyment of property or the income from the property is a present interest in property.

Example. Fred Jones created a trust under the terms of which his son was to get for life the entire income from the property, with the remainder going to Fred's grandson at the death of his son. There is a gift of a present interest to the son and of a future interest to the grandson. However, if Fred directed the trustees to pursue an investment policy that results in future increases in the value of the trust, rather than current income, his son would not have a present interest, and the annual exclusion would not be allowed for Fred's gift to his son.

Proof of gift value. The donor who claims the annual exclusion has the burden of proving the value of the amount of the gift that is claimed to

be a present interest. Generally, the annual exclusion is not allowable unless:

1) The number of eventual donees can be determined, or
2) The interest of each beneficiary can be valued.

The allowance of the exclusion is determined by the facts in each case.

Gift to corporation. A gift to a corporation is a gift of a future interest to its stockholders, and does not qualify for the annual exclusion. But such a gift qualifies for the marital deduction in proportion to the interest of the donor's spouse in the corporation.

Transfers for the benefit of a minor. A transfer for the benefit of a person who has not reached age 21 on the date of the gift is considered a gift of a present interest even though the minor is not given the unrestricted right to the immediate use, possession, or enjoyment of the property or the income from it if certain conditions are met.

Conditions. A gift to a minor is considered a present interest and qualifies for the annual exclusion if the following conditions are met:

1) Both the property and its income may be expended by, or for the benefit of, the minor before reaching 21,
2) Any part of the property or its income not disposed of by the minor's 21st birthday must pass to the minor at that time, and
3) If the minor dies before the age of 21, the property and its income will be payable either to the minor's estate or to whomever the minor may appoint under a general power of appointment.

A transfer qualifies for this exception even though a trustee has discretionary power as to when and how much of the property and its income will be distributed to, or for the benefit of, a minor before the minor's 21st birthday. However, if the terms of the trust impose substantial restrictions on the trustee's exercise of this discretion, the trust does not qualify.

Example. If the trust provided that the trustee could distribute to the minor as much of the property or income as the trustee deemed necessary, but only if the minor's needs could not be met by the minor's parents or own resources, the trust would not qualify as a present interest, because a substantial restriction was imposed on the trustee's power to use the property for the minor's benefit.

Trust instrument. The trust instrument can provide for the continuation of the trust beyond the beneficiary's 21st birthday, as long as the minor has a right upon reaching 21 either to compel immediate distribution of the trust corpus by giving written notice to the trustee, or to permit the trust to continue by its own terms. The terms of the trust also may provide a taker in default if the minor fails to exercise a general power of appointment should the minor die before the age of 21.

Requirements partly satisfied. A gift to a minor that does not satisfy all the requirements to be a present interest may still qualify in part.

Example. A transfer of property in trust with income to be distributed annually to the minor, and corpus to be distributed upon the attainment of age 25, is a gift of a present interest of the income and a gift of a future interest of the corpus.

A gift of trust income to a minor also will qualify for this exception even though the minor is given no interest in the corpus and the income may be accumulated until the minor's 21st birthday, provided the requirements just discussed are met.

Before 1982. For gifts made before 1982 the annual exclusion was $3,000 for gifts to any one person during the calendar year. If gifts were made to a person in different calendar quarters during the year, only the first $3,000 would qualify for the exclusion.

Transitional rule. Generally, the annual exclusion is $10,000 for gifts made after 1981. However, the increased annual exclusion does not apply to a power of appointment granted under a trust created before September 12, 1981, and not amended after that date when the following apply:

1) The power can be exercised after 1981,
2) The power is defined in terms of, or by reference to, the annual exclusion, and
3) The state does not enact a law applicable to that instrument that defines the power as referring to the increased annual exclusion.

Individual retirement arrangements for spouse. A payment by an individual to an individual retirement arrangement for the benefit of a spouse was not considered a gift of a future interest to the extent that the payment was an allowable income tax deduction for 1981. Thus, the deductible part of the payment qualified for the $3,000 annual exclusion. The payments had to be made to an individual retirement account, for an individual retirement annuity, or for a retirement bond.

For 1982, these payments do not qualify for the annual exclusion. However, they may qualify for the marital deduction.

Charitable Deduction

You may deduct from the total amount of gifts you made during the calendar year all gifts included in the total that were made to or for the use of:

1) The United States, a state, a political subdivision of a state, or the District of Columbia, for exclusively public purposes,
2) Any corporation, trust, community chest, fund, or foundation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art. Organizations that foster national or international amateur sports competition, but only if none of their activities involve providing athletic facilities or equipment and organizations for the prevention of cruelty to children or animals are included. These organizations qualify as long as no part of their net earnings benefits any private individual and no substantial activity is undertaken to carry on propaganda, or otherwise attempt to influence legislation or participate in any political campaign on behalf of any candidate for public office,
3) A fraternal society, order, or association operating under the lodge system, if the transferred property is to be used exclusively for religious, charitable, scientific, literary, or educational purposes including the encouragement of art, and the prevention of cruelty to children or animals, or
4) Any veterans organization organized in the United States or any of its auxiliary departments or local chapter or posts, as long as no part of the net earnings benefits any private individual.

Transfers subject to a condition or power. If, at the date of the gift, a transfer to a qualified charity is contingent upon some act or occurrence, a deduction is allowable only if it is virtually certain that the transfer will become effective and the contingency can be ignored.

If the donee or the trustee has the power to divert any part of the property or fund for a use or purpose that is not deductible, only the part of the property or fund not subject to this power is deductible.

Partial interests. If you transfer an interest in property for both charitable and noncharitable purposes, a charitable deduction is allowed for the interest passing to the charity only if the transfer is one of the following. This also applies if you kept an interest in the same property in which you transferred an interest to a charity.

1) ***An undivided portion of your entire interest.*** If you transferred for a charitable purpose an undivided interest, ***not in trust,*** of your entire interest in property, the value of the interest is a deductible charitable contribution. An undivided portion of your entire interest in property must consist of a fraction or a percentage of each interest or right you own in the property, and it must extend over the entire term of your interest in that property or in other property into which the donated property is converted.
2) ***Remainder interest in a personal residence.*** If you transferred for a charitable purpose the remainder interest, ***not in trust,*** in your personal residence, the value of the interest is a deductible charitable contribution.

The term ***personal residence*** means any property you used as a residence, even if it is not used as a principal residence. This includes a vacation home. The term also includes stock you owned as a tenant-stockholder in a cooperative housing corporation, if you used the dwelling you were entitled to occupy as a personal residence. A residence does not include household furnishings that are not fixtures. The charitable remainder interest must be in the residence itself and not in the proceeds to be derived from the sale of the residence.

3) ***Remainder interest in a farm.*** If you transferred the remainder interest, ***not in trust,*** in a farm to a qualified charity, the value of that interest is deductible.

A farm for this purpose means ***any*** land you used or your tenant used to produce crops, fruits, or other agricultural products, or to sustain livestock. A farm includes improvements to it.

4) ***Qualified conservation contributions.*** If you transfer a qualified real property interest to a qualified organization exclusively for conservation purposes, the value of that interest is deductible. For more information on qualified conservation contributions, see Publication 526, *Charitable Contributions.*
5) ***Remainder interests, charitable remainder trusts, and pooled-income funds.*** A charitable deduction is allowed for your transfer of a remainder interest for a charitable purpose in certain cases. The charitable remainder must be in a trust. The trust must be in the

form of a charitable remainder annuity trust, a charitable remainder unitrust, or a pooled-income fund.

A charitable remainder annuity trust is a trust from which a specified amount is paid at least annually to one or more persons who were living at the time the trust was created. The amount must be at least 5% of the initial fair market value of the property placed in trust. At the death of the last income beneficiary, or at the end of a term of up to 20 years, the remainder interest must be held for the benefit of a qualified charitable organization or paid to it.

Generally, a ***charitable remainder unitrust*** is a trust from which a fixed percentage of the net fair market value of its assets, valued annually, is paid at least annually to one or more persons who are living at the time of the creation of the trust. The percentage must be at least 5%. At the death of the beneficiaries or at the end of a term of up to 20 years, the remainder interest is held for the benefit of a qualified charitable organization or paid to it.

A pooled-income fund is a trust maintained by a charity to which you and other donors transfer property and contribute the remainder interest in the property to charity. You keep an income interest for life for your part of the trust property or create an income interest in that property for the life of one or more beneficiaries who are living at the time of the transfer.

Any other form of charitable remainder interest will not qualify for the charitable deduction.

6) ***Income interests, guaranteed annuity interests, and unitrust interests.*** If you transfer an ***income interest,*** whether or not in trust, to a charity and the remainder to a noncharitable entity, the charitable deduction is allowed only if the income interest is in the form of a guaranteed annuity interest or unitrust interest.

The term ***guaranteed annuity interest*** is the right, under the instrument of transfer, to receive a determinable amount for a specified term or for the life or lives of an individual or individuals. The amount must be paid at least annually, and the individual or individuals receiving the interest must be living at the date of the gift.

For example, the annuity may be paid for the life of an individual plus a term of years. An amount is determinable if the exact amount that must be paid under the conditions specified in the instrument of transfer can be ascertained as of the date of the gift.

A guaranteed annuity interest, not in trust, must be paid by an insurance company or by an organization regularly engaged in issuing annuity contracts.

The term ***unitrust interest*** means the right, given in the instrument of transfer, to receive payment at least annually of a fixed percentage of the net fair market value, determined annually, of the property that funds the unitrust.

A unitrust interest, not in trust, must be paid by an insurance company or by an organization regularly engaged in issuing interests otherwise meeting the requirements of a unitrust interest.

7) ***Work of art.*** If you make a qualified contribution of a copyrightable work of art, the work of art and its copyright are treated as separate properties. Therefore, you are allowed a charitable deduction, for gift tax purposes, for the transfer to a qualified organization of a work of art, even if you do not transfer the copyright to the charity.

The term ***work of art*** means any tangible personal property for which there is a copyright under federal law. A *qualified contribution* is the transfer of property to a qualified organization if the use of the property is related to the organization's exempt purpose or function. A ***qualified organization*** is any religious, charitable, scientific, educational, or other organization described in section 501(c)(3) of the Code that is not a private foundation.

Before 1982. A work of art and its copyright were treated as two interests in the same property. Therefore, if before 1982 you transferred a copyrightable work of art, you also had to transfer the copyright on that work of art to qualify for a charitable deduction.

Partial interests, valuation. The amount of the deduction in the case of a partial interest (including a remainder interest) is the fair market value of the interest on the date of the gift. The fair market value of an annuity, life estate, term for years, remainder, reversion, or unitrust interest is its present value.

If the valuation of the interest depends on the continuation or termination of more than one life, or upon a term certain concurrent with one or more lives, a special factor must be used. Publications 723, 723A, and 723B, contain many of these factors. You can get them from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402. If you need a special factor for an actual transaction, you may request the factor from the Commissioner of Internal Revenue. See the procedure for requesting actuarial factors later in this publication.

Marital Deduction

You may deduct from the total amount of gifts you made during the calendar year the value of gifts you made to your spouse. The amount of the marital deduction is unlimited. Some gifts are not deductible. See *Nondeductible interests*, below.

To qualify for the marital deduction the following conditions must be met at the time the gift is made.

1) The spouses must be married. A gift to a person who becomes your spouse after the gift has been made does not qualify for the marital deduction.
2) The spouse making the gift must be a U.S. citizen or resident. The spouse receiving the gift does not have to be a U.S. citizen or resident.

Nondeductible interests. Not all interests qualify for the marital deduction. Nondeductible interests include amounts not included in your total gifts for the calendar year and property interests transferred to your spouse that are *terminable interests.*

Terminable Interests

For purposes of the marital deduction there is a distinction between "property" and an "interest in property." "Property" refers to the underlying property in which various interests exist. Each of the interests in property is not considered "property." A ***terminable interest in property*** is an interest that will end or fail after a period of time or when some contingency occurs or fails to occur. Examples of terminable interests are life estates, annuities, estates for a term of years, and patents.

Terminable interests that qualify for the marital deduction are discussed later under *Exceptions.* A terminable interest transferred to a spouse will ***not*** qualify for the marital deduction if both (1) and (2) apply:

1) The donor also—
   a) Transferred an interest in the same property for less than adequate consideration to someone other than his or her spouse, or
   b) Retained an interest in the same property, or
   c) Retained a power to appoint an interest in the same property, AND
2) Because of this transfer or retention, the other donee, the donor, or the person to whom an interest may be appointed, may possess or use any part of the property after the spouse's interest ends or fails.

Example. If Charles Herb gave his wife a patent that has a useful life of 10 years, he has given her a terminable interest. But since no one will enjoy the use of the patent after her interest ends, Charles is entitled to a marital deduction. However, if Charles gives his wife only the first 5 years of the patent and gives his son the last 5 years, he will not be entitled to a marital deduction.

Civil service annuity. The election of a survivor annuity under the Civil Service Retirement System by a retiring federal employee is a transfer for which the marital deduction is not allowable.

Exceptions. There are exceptions to the terminable interest rule. A terminable interest qualifies for the marital deduction, if the transfer qualifies as one of the following exceptions.

Joint interests. If you transfer a property interest to your spouse and you and your spouse are the only joint tenants or are tenants by the entirety, you are not considered to have retained an interest in the property. The marital deduction is allowed even if you may receive the property because your spouse dies or the tenancy is severed.

Life estate with power of appointment. If you make a transfer that meets all of the following conditions, you are considered to have made a transfer to your spouse that qualifies for the marital deduction. You are not considered to have retained an interest or transferred an interest to someone other than your spouse.

The transfer to your spouse will qualify if:

1) Your spouse is entitled for life to all the income from the entire interest,
2) Your spouse must receive the income annually or at more frequent intervals,
3) Your spouse must have the power, exercisable in his or her favor or for his or her estate, to appoint the entire interest,
4) Your spouse must be able to exercise the power alone and (whether exercisable by will or during life) in all events, and
5) Your spouse must have the only power to appoint any part of the interest in the property to another person.

If either the right to income or the power of appointment given to your spouse pertains only to a specific portion of a property interest, the marital deduction is allowed only to the extent that the rights of your spouse meet all of the five conditions. For example, if your spouse is to receive all the income from the entire interest, but only has a power to appoint one-half of the entire interest, then only one-half qualifies for the marital deduction.

A ***partial interest*** in property is treated as a specific portion of an entire interest only if the rights of your spouse to the income and to the power constitute a fractional or percentile share of the entire property interest. This means that the interest or share will reflect any increase or decrease in the value of the entire property interest. Thus, if the right of the spouse to income and the power are for a specified percentage of the property, the interest is a specific portion. If the annual income of the spouse is limited to a specific sum, or if the spouse has a power to appoint only a specific sum out of a larger fund, the interest is not a deductible interest.

Qualified terminable interest property. If you give your spouse a life interest in property, the gift generally is a terminable interest and does not qualify for the marital deduction. However, you may elect to treat the life interest as a qualified terminable interest for which the marital deduction is allowed. Make the election on the gift tax return for the calendar year in which you transferred the interest. You cannot change this election.

For this purpose, property includes an interest in property. A specific portion of property is treated as separate property.

You may make the election for any property that you transfer and in which your spouse has a qualifying income interest for life. This qualified terminable interest property is treated as transferred to your spouse and qualifies for the marital deduction. You are not considered to have retained any part of the property or transferred any part to any person other than your spouse.

Your spouse has a ***qualifying income interest for life*** if:

1) Your spouse is entitled to all the income from the property for life, and
2) The income is payable annually or at more frequent intervals, and
3) No person has the power to appoint any part of the property to any person other than your spouse.

An income interest granted for a term of years or a life estate that will end if a specified event occurs does not qualify. No person, including the spouse, can appoint any part of the property during the spouse's life. A power that can be exercised only at or after the spouse's death is allowable. A trustee may invade the corpus of a trust for the benefit of the spouse.

Special rules apply to the disposition of all or part of the qualifying income interest by your spouse. See *Certain Marital Deduction Property* discussed earlier under *Gifts in General*. See also *Certain Martial Deduction Property*, in the *Estate Tax* section of this publication.

Charitable remainder trust. If you create a charitable remainder annuity trust or a charitable remainder unitrust in which the only noncharitable beneficiaries are you and your spouse, you can claim a marital deduction for the interest in the trust that you transfer to your spouse. A ***noncharitable beneficiary*** is any beneficiary of the trust other than an organization for which a charitable contribution is allowed.

Before 1982. The exceptions to the rules on a terminable interest for ***qualified terminable interest property*** and for a ***charitable remainder trust*** do not apply to gifts made before 1982. In addition, the following items applied to gifts between spouses made before 1982.

Community property. No marital deduction was allowed for a gift to a spouse if the property transferred was, at the time of the gift, held by the spouses as community property under the law of any state or possession of the United States, or any foreign country.

Limitation. For gifts made after 1981, the amount of the marital deduction is unlimited. For gifts made after 1976 and before 1982, the amount of the deduction was limited to:

1) The first $100,000 (reduced by any deductions allowed after 1976), and
2) 50% of such transfers in excess of $200,000.

Gift Tax Computation

Use the ***Unified Rate Schedule*** shown at the end of this publication to determine the gift tax on your taxable gifts. Your taxable gifts are your total gifts reduced by the annual exclusion, the charitable deduction, and the marital deduction.

The gift tax before any credits is the excess of:

1) A tentative tax on the sum of—
   a) The taxable gifts for the calendar year, and
   b) The taxable gifts for all preceding calendar periods,

   Over
2) A tentative tax on the total taxable gifts for all preceding calendar periods.

Taxable gifts for all ***preceding calendar periods*** means all taxable gifts made after June 6, 1932. The taxable gifts for these periods are determined under the gift tax provisions that applied when the gift was made. The amount of the annual exclusion allowed in the preceding periods is not included in taxable gifts. However, the specific (lifetime) exemption is limited to $30,000 for gifts made before 1977. The current Unified Rate Schedule is used for determining the tentative tax in (2).

Before 1982. The computation of the gift tax for gifts made before 1982 is basically determined in the same manner except that, generally, the returns were filed quarterly and the tax was determined quarterly instead of annually. Use the Unified Rate Schedule in effect before 1982.

Unified Credit

If you are a U.S. citizen or resident, you must use the unified credit to reduce any gift tax for which you may be liable. The amount of the credit depends on when the gift was made.

For gifts made in:	The credit is:
1981	$ 47,000
1982	$ 62,800
1983	$ 79,300
1984	$ 96,300
1985	$121,800
1986	$155,800
1987 and later	$192,800

Adjustments to the credit. You must reduce the amount of the allowable credit by the amounts allowable as credits for all preceding calendar periods.

The credit also is reduced by 20% of the specific (lifetime) exemption allowed for gifts made after September 8, 1976, and before 1977. The credit is not reduced for any amount allowed as a specific exemption for gifts made before September 9, 1976.

Example. In October 1976, George Ash, single, made a gift to his niece, Sally, of property valued at $53,000. On his federal gift tax return, George claimed all of the specific exemption in the amount of $30,000 plus the annual exclusion of $3,000.

In 1981, George made a gift to his nephew, Barry. The gift tax before the unified credit was $48,000. The unified credit for 1981 is $47,000, however, because George had claimed the specific exemption for the October 1976 gift, the credit must be reduced by $6,000 (20% × $30,000). Therefore, the allowable unified credit is $41,000.

After the 1981 gift, George has used $47,000 of his unified credit. If he makes a gift in 1982 his allowable unified credit is $15,800 ($62,800 − $47,000).

Limit. The amount of unified credit you may claim may not exceed the amount of the tax for the calendar year.

Examples of Gift Tax Computation

Using the same facts as in the example under *Unified Credit*, assume that George Ash made a gift of $173,625 in 1981 and that the only prior taxable gift was the one made in 1976. George computes his gift tax for 1981 as follows:

Total gifts for 1981	$173,625
Minus: Annual exclusion	3,000
Taxable gifts	$170,625
Plus: Prior taxable gifts	20,000
Total taxable gifts	$190,625
Tentative tax on total taxable gifts	$ 51,800
Minus: Tentative tax on prior taxable gifts (using present tax rates)	3,800
Gift tax before unified credit	$ 48,000
Minus: Allowable unified credit ($47,000 − $6,000)	41,000
Net gift tax	$ 7,000

In 1982 George makes a gift to his niece of property valued at $100,000. He computes his gift tax for 1982 as follows:

Total taxable gifts for 1982	$100,000
Minus: Annual exclusion	10,000
Taxable gifts	$ 90,000
Plus: Prior taxable gifts	190,625
Total taxable gifts	$280,625
Tentative tax on total taxable gifts (rounded)	$ 81,213
Minus: Tentative tax on prior taxable gifts	51,800
Gift tax before unified credit	$ 29,413
Minus: Allowable unified credit ($62,800 − $47,000)	15,800
Net gift tax	$ 13,613

Gifts by Nonresident Noncitizens

For an individual who is neither a citizen nor a resident of the United States, the federal gift tax applies to a transfer only if the property is situated in the United States. The tax applies only to transfers of real and tangible personal property.

If a person is a resident of a U.S. possession and acquired U.S. citizenship only because of citizenship, birth, or residence in the U.S. possession, the person is considered a nonresident noncitizen for gift tax purposes.

Location of Property

Property is considered located in the United States if it is:

1) Real property located in the United States,

2) Tangible personal property located in the United States, and

3) For an expatriate, intangible personal property consisting of a property right issued by or enforceable against a resident of the United States or a domestic corporation and intangible personal property of the following types—

   a) Shares of stock issued by a domestic corporation,

   b) A debt obligation of a U.S. citizen or resident, a domestic partnership, a domestic corporation (including moneys on deposit with a domestic corporation or its foreign branch), and any estate or trust (other than a foreign estate or trust), and

   c) A debt obligation of the United States, a state or any political subdivision of a state, or the District of Columbia.

Tax treaties. The United States has gift tax treaties for the avoidance of double taxation of gifts with the countries listed below. These treaties, in addition to making a foreign gift tax credit for gift taxes paid to those countries available to donors (who are citizens or residents of the United States), provide certain rules for determining the situs of property. These rules, which in some cases differ from those discussed, are used in determining the credit allowable to donors who are citizens or residents. They are also used for determining the property subject to the federal gift tax on gifts by donors who are nonresident noncitizens and who come within the scope of the treaties.

Tax treaty countries. The following are tax treaty coutries:

Australia

France

Japan

United Kingdom

Exclusions, Deductions, and Credits

Annual exclusion. The annual exclusion provisions (discussed earlier) apply to nonresident noncitizens.

Charitable deduction. The deduction for charitable and similar gifts by nonresident noncitizens, is governed by the same rules that apply to U.S. citizens and residents.

However, gifts to, or for the use of, a trust, community chest, fund, foundation, or fraternal order or society operating under the lodge system are deductible only if the gifts are to be used within the United States exclusively for tax-exempt purposes. Also, if the gifts are made to or for the use of a corporation, the corporation must be one created or organized under the laws of the United States or of any state or territory thereof.

Marital deduction. A marital deduction is allowed only if the donor spouse is a citizen or resident of the United States.

Unified credit. There is no unified credit against the gift tax imposed on transfers by nonresident noncitizens.

Gift Splitting

If either of the spouses is a nonresident noncitizen, they may ***not*** elect to split the gift made by one spouse to a third party.

Recipient's Basis in Gifts

To figure the recipient's basis in gift property, the donor's adjusted basis in the property, its fair market value at the time of the gift, and the gift tax paid on the gift must be known.

Fair market value less than donor's adjusted basis. If the fair market value of the property at the time of the gift was less than the donor's adjusted basis just before the gift was made, the recipient's basis for depreciation, depletion, or amortization and for gain on its sale or other disposition, is the donor's adjusted basis. The recipient's basis for figuring a loss is the fair market value of the property at the time of the gift.

However, if the donor's adjusted basis is used for determining a gain and a loss is computed, and then the lower fair market value basis is used for determining a loss and a gain is computed, there is neither a gain nor a loss.

Example. You received a gift of income-producing property having an adjusted basis of $10,000 at the time of the gift. The fair market value at the time of the gift was $9,000. If you sell the property for $9,500, you have neither gain nor loss. There is no gain because the basis for determining gain is $10,000; there is no loss because the basis for determining loss is $9,000.

Fair market value more than donor's adjusted basis. If the fair market value of the property at the time of the gift was equal to or more than the donor's adjusted basis just before the gift was made, the recipient's basis for depreciation, depletion, or amortization, and for gain or loss on its sale or other disposition, is the donor's adjusted basis at the time of the gift, increased by the gift tax paid on the gift. This basis, however, cannot be more than the fair market value of the property at the time of the gift.

Gift tax paid on the gift. For gifts made after 1976, the recipient's basis (donor's adjusted basis) is increased by the gift tax paid that is attributable to the net appreciation in value of the gift. This is determined by multiplying the total gift tax paid on the gift by a fraction. The numerator of the fraction is the net appreciation in value of the gift and the denominator is the amount of the gift. The ***net appreciation in value of the gift*** is the fair market value of the gift minus the donor's adjusted basis..

Example. In 1982 you received a gift of property from your mother. At the time of the gift the property had a fair market value of $50,000 and an adjusted basis to her of $20,000. Assume that she paid a gift tax of $9,000 on the property. For purposes of determining depreciation, depletion, or amortization, and gain or loss, your basis is $25,400 figured as follows:

Fair market value	$50,000
Less: Adjusted basis	20,000
Net appreciation	$30,000
Gift tax paid	$ 9,000
Multiplied by ($30,000 ÷ $50,000)	60%
Gift tax attributable to net appreciation	$ 5,400
Adjusted basis of property to your mother	20,000
Basis to you	$25,400

Gift made before 1977. If the recipient received property by gift before 1977, the basis in the property (donor's adjusted basis) is increased (but not above fair market value at the time of the gift) by the total gift tax paid on the gift.

Gift made before 1921. If the property was received by gift before 1921, the recipient's basis for depreciation and for gain or loss on the sale or other disposition of the property is its fair market value at the time of the gift.

Generation-Skipping Transfer Tax

In general, distributions of assets from a generation-skipping trust are subject to a generation-skipping transfer tax. A ***generation-skipping trust*** is a trust that provides for benefits to pass to two or more generations that are younger than the generation of the grantor of the trust. This tax is not imposed on the outright transfer of property to a person who is in a generation younger than the transferor's.

The generation-skipping provisions do not apply to transfers under a trust that was irrevocable on June 11, 1976 (to the extent the transfer is not made from additions to corpus after June 11, 1976).

These provisions do not apply to transfers under a revocable trust or will in existence on June 11, 1976, that becomes irrevocable because of a decedent's death before January 1, 1983, if the instrument has not been amended to create or increase the amount of any generation-skipping transfer. If a person on June 11, 1976, was under a mental disability to change the disposition of property, the date the instrument must become irrevocable is January 1, 1983, or the date that is two years after the date this person first regains competence to dispose of property.

Any reference to a generation-skipping trust includes a generation-skipping trust equivalent. Although it is not a trust, a generation-skipping trust equivalent is an arrangement that has substantially the same effect as a generation-skipping trust. This includes arrangements involving life estates and remainders, estates for years, other split interests, insurance, and certain survivor annuities.

If the deemed transferor is dead at the time of a generation-skipping transfer, all procedural and administrative provisions that apply to estate tax will apply to generation-skipping transfers. If the deemed transferor is alive at the time of the generation-skipping transfer, all procedural and administrative provisions that apply to gift tax will apply to generation-skipping transfers. These estate and gift tax rules apply only to the extent that they are not inconsistent with express provisions of the generation-skipping tax sections. The provisions for installment payment of estate taxes do not apply to the generation-skipping tax.

Return Requirements

Generally, the person described below must file a generation-skipping transfer tax return for every generation-skipping transfer for each deemed transferor. A return is required even though no tax is due for any reason, including the exclusion for property transferred to the grantor's grandchildren or the allowability of credits.

Generally, the following must file Form 706–B, *Generation-Skipping Transfer Tax Return:*

1) The transferee in the case of a taxable distribution.
2) The trustee in the case of a taxable termination. However, in the case of a trust equivalent, the transferee must file the return.

If the transferee is legally incompetent or otherwise incapable of making the return, the guardian of that person's property must file it. If no guardian has been appointed, the person having control of the transferee's property must file the return.

The executor of a transferee's estate must file a return for a transferee who dies before filing a return which was required.

When filed. The due date depends on whether the deemed transferor is alive at the end of the trust's tax year. See the *Instructions for Form 706–B.*

Where filed. The return is filed with the Internal Revenue Service Center with which an estate or gift tax return of the deemed transferor would be filed. The return for a nonresident noncitizen, must be filed with the Internal Revenue Service Center, Philadelphia, PA 19255.

Amended return. If a deemed transferor dies within 3 years after a generation-skipping transfer has occurred, an amended return must be filed for the transfer by the date 6 months after the last day allowed for filing the deemed transferor's estate tax return (including extensions).

For additional information, refer to the *Instructions for Form 706–B.*

If the Service proposes a different value of property for purposes of the generation-skipping tax, the trustee or transferee is entitled to request from the Service a statement concerning its basis for valuation of property included in the generation-skipping transfer.

Caution: The information on return requirements is based on the latest proof copy of Form 706–B that was available at the time this publication was printed. Follow the instructions on the final version of Form 706–B for filing that return.

Liability for the Tax

Neither the deemed transferor nor his estate is liable for the tax. Generally, the tax will be paid by the trust.

If the tax is not paid when due, the recipient of a ***taxable distribution*** is personally liable for the tax. The recipient's liability is limited to the fair market value of the interest received at the time of the distribution. If there is a ***taxable termination*** of a trust, the trustee is personally liable for the generation-skipping tax.

Regulations will be issued on how a trustee may request information from the Internal Revenue Service concerning the transfer tax rate bracket of the deemed transferor. If a transfer is made to the grantor's grandchild, the trustee may request information concerning the extent to which the $250,000 exclusion has been used by the deemed transferor. The trustee will not be liable for any increase in tax that is due to the tax rate or remaining exclusion information supplied by the Service.

Lien

The generation-skipping transfer tax constitutes a lien on the property transferred until the tax is paid in full or the statute of limitations expires. When property passes to more than one transferee in a simultaneous transfer, the property passing to each transferee is liable for the full amount of tax on the entire transfer.

Generation-Skipping Transfers

Generation-skipping transfers (also referred to as transfers) include:

1) ***Taxable distributions,*** or
2) ***Taxable terminations.***

These terms do not include a transfer subject to estate or gift tax. They also do not include a transfer that is eligible for the exclusion for transfers to grandchildren, or property that was already subject to the generation-skipping transfer tax at those generation levels (prior transfer exclusion).

In the event the death of an individual or any other occurrence is determined to be a taxable termination and such occurrence requires the distribution of part or all of the same property in a taxable distribution, the transfer is deemed not to be a taxable distribution to the extent that it is a taxable termination.

Exclusion for transfers to grandchildren. Transfers to the grandchildren of the grantor are taxable terminations or distributions only if they are more than $250,000 for each deemed transferor (defined later). This limitation is applied to transfers from one or more trusts in the order in which the transfers are made or deemed made.

Prior transfer exclusion. The terms taxable termination and taxable distribution do not include transfers to the extent that:

1) The deemed transferor in any prior transfer of the trust property being transferred was assigned to the same generation as, or a lower generation than, the generation assignment of the deemed transferor in the present transfer,
2) The transferee in any prior transfer was assigned to the same generation as, or a higher generation than, the generation assignment of the transferee in the present transfer, and
3) The transfers are not made for the purpose or effect of avoiding the generation-skipping tax.

Taxable Distributions

A taxable distribution is any distribution from a generation-skipping trust that is not out of the income of the trust to any younger-generation beneficiary who is assigned to a generation younger than the generation assignment of any other person who is a younger-generation beneficiary. An individual who has had only a future interest or future power (or both) in the trust is not considered to be a younger-generation beneficiary.

If there are distributions out of income and out of other amounts during the tax year of the trust, the distribution of the income is considered distributed to the oldest-generation beneficiary first.

Any portion of tax imposed on a generation-skipping transfer that is paid out of the income or corpus of a trust is considered an additional generation-skipping transfer.

Example. Debbie Rose created a trust that provided income for life to her daughter, Joan, with the remainder to her great grandchild, Jimmy. The trust distributed all the income to Joan and also made a distribution of corpus to Jimmy. The distribution to Jimmy is a taxable distribution because it was not out of trust income, and Jimmy is in a generation younger than that of Joan.

Taxable Terminations

A taxable termination is a termination of the interest or power of any younger-generation beneficiary who is assigned to a generation older than that of any other person who is a younger-generation beneficiary. A taxable ter-

mination generally occurs by reason of death, lapse of time, or the exercise or nonexercise of the interest or power in a generation-skipping trust. A termination of a future interest or future power (or both) in the trust is not a taxable termination.

An assignment of a beneficiary's interest in a generation-skipping trust is not a taxable termination. However, the death of the person making the assignment would be a taxable termination and the generation-skipping transfer tax will be imposed on the value of the trust on the date of this person's death.

Example. Using the same facts as in the example under *Taxable Distributions*, if Joan dies, and the remainder interest is transferred to Jimmy, a taxable termination has occurred. In this situation, Joan's death terminated the life interest of the younger-generation beneficiary who was a member of a generation older than that of any other younger-generation beneficiary (Jimmy) under the trust.

Deemed transferees of certain terminations. If at the time of any termination it is not clear who the transferee is, then (except as provided in regulations to be prescribed by the Secretary) the property will be deemed transferred on a pro rata basis to each beneficiary of the trust according to how much each of them would receive under the maximum exercise of discretion on their behalf. It is presumed that the discretion will be exercised per stirpes, unless otherwise stated.

Per stirpes means that a class or group of distributees take the share that their deceased ancestor would have been entitled to, taking it by their right of representing the ancestor and not as so many individuals.

Two or more beneficiaries in same generation. If two or more younger-generation beneficiaries with present interests or present powers are assigned to the same generation, the transfer constituting a taxable termination for each such beneficiary is deemed to occur when the termination of the last such present interest or present power occurs.

Example. A grantor creates a trust providing that the trustee, in his discretion, is to distribute the income for the benefit of the grantor's three children during their lives, and is to distribute the corpus of the trust to his great grandchildren upon the death of the last surviving child. No tax would be imposed until all three of the children have died. At that time, there would be a taxable termination with respect to the trust and the tax base (the trust assets) would be valued.

More than one present interest or present power. If one younger-generation beneficiary of a trust has both a present interest and a present power, or more than one present interest or present power in the trust, the termination of each power or interest is treated as occurring when the termination of the last remaining interest or power occurs.

Example. If an individual is entitled to receive all the trust income until the individual dies or reaches age 35 and also has a power commencing at age 35 to withdraw 5% of the trust corpus for life, the generation-skipping tax would be imposed at the individual's death and not when the individual attains age 35.

Unusual order of terminations. If a present interest or present power of a younger-generation beneficiary terminates and immediately after such termination a beneficiary assigned to a higher generation has a present interest or present power in the trust, the interest or power of the younger-generation beneficiary will not be deemed to have terminated until such interest or power of the "older" generation beneficiary terminates.

Example. A discretionary trust is created providing income for life to the grantor's spouse, Mary, and two children, Al and Bob, with the remainder to be distributed to the grantor's grandchildren. In this situation, if Al and Bob both die before Mary, no taxable termination occurs until her death. However, at her death, Al and Bob would be deemed transferors and the tax base would be determined at the time of the taxable termination, that is, at Mary's death.

Where an unusual order of termination occurs, as in the above example, the rules for generation-skipping transfers shall be applied first to the termination of the interest or power of the older beneficiary (Mary) as if this termination occurred before the termination of the power or interest of the younger beneficiary (Al and Bob). The value of any property taken into account for purposes of determining tax (if any) imposed on the termination of the younger beneficiary's interest or power will be reduced by the tax imposed on the termination of the older beneficiary's interest or power.

Special rule. The rules just discussed in *Two or more beneficiaries in same generation*, and *Unusual order of terminations*, will both apply when a person assigned to the same generation as, or a higher generation than, the person whose power or interest terminates has a present power or interest immediately after the termination and this power or interest arises as a result of the termination.

Termination of power. In the case of the termination of any power, the property transferred is deemed to be the property subject to the power immediately before the termination.

Younger-Generation Beneficiary

A ***younger-generation beneficiary*** is any beneficiary who is assigned to a generation younger than the grantor's generation. The time for determining if a person is a younger-generation beneficiary is immediately before the transfer. In the case of a series of related transfers, the time for this determination is immediately before the first transfer.

A ***beneficiary*** is any person who has a present or future interest or power in a trust.

The term ***power*** means the ability to establish or alter the beneficial enjoyment of the corpus or income of the trust. It does not include the mere right of management of the trust.

A person who has a right to income or corpus, or who is a permissible recipient of income or corpus, has an ***interest*** in a trust.

Limited power to appoint among lineal descendants of the grantor. An individual is not deemed to have any power in a trust if he or she has only the power to dispose of trust corpus or income to a beneficiary or a class of beneficiaries who are lineal descendants of the grantor and who are assigned to a generation younger than the generation assignment of that individual.

Powers of independent trustees. An individual is not deemed to have a power in a trust if that individual:

1) Is a trustee who has no interest in the trust (other than as a potential appointee under a power of appointment held by another),
2) Is not a ***related or subordinate trustee***, and
3) Does not have any present or future power in the trust other than a power to dispose of trust corpus or income to a beneficiary or a class of beneficiaries designated in the trust instrument.

Related or subordinate trustee. A related or subordinate trustee is any trustee who is assigned to a younger generation than the grantor and who is any of the following:

1) The spouse of the grantor or of any beneficiary,
2) The father, mother, lineal descendant, brother, or sister of the grantor or of any beneficiary,
3) An employee of the grantor or of any beneficiary,
4) An employee of a corporation in which the stockholdings of the grantor, the trust, and the beneficiaries of the trust are significant from the viewpoint of voting control,
5) An employee of a corporation in which the grantor or any beneficiary of the trust is an executive,
6) A partner of a partnership in which the interest of the grantor, the trust, and the beneficiaries of the trust are significant from the viewpoint of operating control or distributive share of partnership income, or
7) An employee of a partnership in which the grantor or any beneficiary of the trust is a partner.

Ascertainment of generations. Generations are determined along family lines or by the date of birth if the beneficiary is unrelated.

Family lines. A generation to which any person, other than the grantor, belongs is determined according to the following rules:

1) An individual who is a lineal descendant of a grandparent of the grantor is assigned to that numbered generation that results from comparing the number of generations between the grandparent and the individual with the number of generations between the grandparent and the grantor,
2) An individual who at any time has been married to a lineal descendant of a grandparent of the grantor is assigned to the same generation as the lineal descendant,
3) The present or former spouse of the grantor is assigned to the grantor's generation, and
4) Relationships by half-blood or adoption are considered whole-blood relationships.

Example. A husband, wife, and their brothers and sisters would be one generation; their children including adopted children would be the first younger generation; the grandchildren would be the second younger generation, and so forth.

Unrelated beneficiaries. An individual not assigned to a generation under the family line rules is assigned to a generation based on his or her date of birth. Individuals not more than 12½ years younger than the grantor are treated as members of the grantor's generation. Individuals more than 12½ years younger than the grantor but not more than 37½ years younger are considered members of the grantor's children's generation (the first generation younger than the grantor). Subsequent generations are measured from the grantor's birth every 25 years.

Special rules. Individuals eligible to be assigned to more than one generation will be assigned to the youngest of the generations available.

If any beneficiary of the trust is an estate or a trust, partnership, corporation, or other entity, each individual having an indirect interest or power in the trust through such entity is treated as a beneficiary of the trust and is assigned to a generation under the rules just described.

Deemed Transferors

The determination of the deemed transferor is important because the deemed transferor's marginal tax bracket is used to determine the amount of tax that is imposed on the transfer.

A deemed transferor of a generation-skipping transfer generally is the parent (living or deceased) of the transferee who is more closely related to the grantor of the trust. A parent related to the grantor by blood or adoption is more closely related than a parent related to the grantor by marriage. If neither parent is related to the grantor, the parent having the closer affinity to the grantor is the deemed transferor.

However, if this parent is not a younger-generation beneficiary at any time, and there is another ancestor (grandparent, etc.) of the transferee who is related to the grantor by blood or adoption (and not by marriage) and who is a younger-generation beneficiary of the trust, the youngest such ancestor is considered the deemed transferor.

Example. If a trust is created for the benefit of the grantor's grandchild for life with the remainder to the grantor's great grandchild, the grandchild is the deemed transferor when the trust property passes to the great grandchild.

If a trust is created for the benefit of persons outside the grantor's family, the deemed transferor is the parent of the transferee having the closest affinity with the grantor. Generally, this person will be the person named in the will or trust instrument, or the lineal descendant of that person having the intervening interest or power in the trust.

In the case of a sprinkling trust, a taxable termination does not occur until the interest of the last member of a generation of beneficiaries has terminated. At that point, each member of that generation becomes the deemed transferor with respect to trust property transferred to that member's descendants.

Deductions

When a taxable termination occurs at or after the death of the deemed transferor, the amount of the generation-skipping transfer is reduced by any expenses, indebtedness, taxes, and losses to the extent that a deduction would have been allowable for these items if the amount of the trust had been includible in the deemed transferor's gross estate and the deemed transferor had died immediately before the generation-skipping transfer. Therefore, trustee's fees, costs of administration, and other losses and expenses may be deducted from the amount of any generation-skipping transfer to the extent that these items are paid for or sustained by the trust, are attributable to property which is included in the generation-skipping transfer, and have not previously been deducted for estate or income tax purposes.

In the case of a taxable distribution, the amount of the generation-skipping transfer is reduced by any expense incurred in connection with the determination, collection, or refund of the generation-skipping transfer tax imposed.

Charitable deduction. The estate or gift tax charitable deduction is allowed to the extent that the property passes to a charity.

Computation of Tax

The amount of tax imposed on a generation-skipping transfer is the excess of:

1) A tentative tax (using the Unified Rate Schedule, as in effect on the date of the transfer) on the sum of—
   a) The fair market value of the transferred property determined as of the transfer date or the alternate valuation date if elected,
   b) The total fair market value of all prior generation-skipping transfers of the deemed transferor,
   c) The amount of adjusted taxable gifts (modified for any split gifts made within 3 years of death of a spouse) made after 1976 by the deemed transferor before this generation-skipping transfer, and
   d) The taxable estate of the deemed transferor, if the deemed transferor has died at the same time as, or before, this generation-skipping transfer,

   OVER:
2) A tentative tax on the sum of the amounts determined in (1)(b), (c), and (d).

The ***Unified Rate Schedule*** is shown at the end of this publication.

Multiple simultaneous transfers. If two or more transfers that are taxable and have the same deemed transferor occur by reason of the same event, the generation-skipping transfer tax imposed on each transfer is the amount that bears the same ratio to:

1) The generation-skipping transfer tax that would have been imposed if the multiple simultaneous transfers were treated as a single transfer, ***as***
2) The fair market value of each of the properties transferred in the multiple transfer ***bears*** to the total fair market value of all property transferred.

Transfers within 3 years of deemed transferor's death. The principles relating to adjustments for gifts made within 3 years of a decedent's death, as in effect before 1982 (see *Transactions Within 3 Years of Death*, under *Estate Tax*), will apply to generation-skipping transfers made during the 3–year period ending on the deemed transferor's date of death. The amount of the generation-skipping tax imposed on any transfer during the 3–year period will be redetermined as if the transfer had occurred after the death of the deemed transferor and appropriate adjustments will be made for the amount of any prior transfer taken into account by this deemed transferor as generation-skipping transfers or adjusted taxable gifts.

This treatment is similar to the estate tax treatment of gifts made within 3 years of a decedent's death, if the decedent died before 1982. Thus, in this case, the generation-skipping transfer is to be taxed, at the deemed transferor's unified tax rate, taking into account cumulative lifetime and death-time transfers and not just the adjusted taxable gifts as of the date of the generation-skipping transfer.

Alternate Valuation Date

Under the estate tax provisions, the executor of an estate can elect to use an alternate valuation date to value the property in the estate. The trustee of a generation-skipping trust can also elect to use an alternate valuation date to value property transferred in certain taxable terminations. If the trustee makes this election, the executor of the deemed transferor's (or beneficiary's) estate does not have to elect the alternate valuation date. (See *Alternate Valuation* under *Estate Tax*.)

The alternate valuation date for estate tax purposes generally is the date 6 months after the decedent's death. For the generation-skipping transfer tax the date is 6 months after:

1) ***The date of the death of the deemed transferor or beneficiary*** if there are one or more generation-skipping transfers from the same trust that have the same deemed transferor and that are taxable terminations occurring at the same time as the death of the deemed transferor or at the same time as the death of a trust beneficiary assigned to an older generation than the deemed transferor,

   OR
2) ***The date of the generation-skipping transfer,*** if there are one or more generation-skipping transfers from the same trust with different deemed transferors that are taxable terminations occurring on the same day and that would, but for the special rule for such terminations, have occurred at the same time as the deaths of the individuals who are the deemed transferors with respect to the transfers. (The special rules are those for *Two or more beneficiaries in same generation*, *More than one present interest or present power*, *Unusual order of terminations*, and *Special rule* discussed under *Taxable Terminations*.)

Credits

Unified credit. If the transfer occurs at, or after, the death of the deemed transferor, any unused part of the unified credit is allowed as a credit against the generation-skipping transfer tax. The credit allowed under this rule cannot, however, exceed the generation-skipping transfer tax. The unused part of the unified credit is the amount of the credit that exceeds the sum of the estate tax, and the generation-skipping transfer tax on prior transfers.

Credit for state death taxes. A credit is allowed against the generation-skipping transfer tax in an amount equal to the estate, inheritance, legacy, or succession tax actually paid to any state or the District of Columbia in respect to any property included in the generation-skipping transfer if the generation-skipping transfer occurs at the same time as, or after, the death of the deemed transferor. This credit is allowed only to the extent of the lesser of:

1) The portion of the taxes levied on the transfer, or
2) The excess of—
   a) The credit allowed for state death taxes for estate tax purposes if the adjusted taxable estate of the decedent had been increased by this transfer and all prior generation-skipping transfers that had the same deemed transferor and were subject to this tax, ***over***

b) The total amount of credit for state taxes plus the total amounts allowable with respect to the prior generation-skipping transfers.

Credit for tax on prior transfers. The credit for tax on prior transfers is allowed as an offset against the generation-skipping transfer tax.

The prior transfer tax credit is allowable if the estate tax had been imposed on the property in trust, and within a 10-year period thereafter, the generation-skipping tax is imposed upon the death of the deemed transferor. Likewise, if the deemed transferor is deceased at the time of a generation-skipping transfer, property that is subject to the tax on generation-skipping transfers is to be treated as passing from the deemed transferor to the transferee, and the generation-skipping tax is to be treated as an estate tax for purposes of the previously taxed property credit. (See *Credit for Tax on Prior Transfers* under *Estate Tax*.)

Nonresident Noncitizens

If at the time of a generation-skipping transfer, a living deemed transferor is a nonresident noncitizen of the United States, only property taken into account for gift tax purposes is considered for generation-skipping transfer tax purposes. Only such property will be taken into account in determining the basis of the property transferred.

On the other hand, if the deemed transferor (nonresident noncitizen) has died at the same time as, or before, the transfer, only the property taken into account for estate tax purposes is considered for generation-skipping transfer tax purposes. Only such property will be taken into account for purposes of determining the basis of the property transferred.

Miscellaneous Provisions

Disclaimers

For purposes of the disclaimer rules, the event that triggers the 9-month period allowed for a qualified disclaimer is the original date the interest is transferred to the disclaiming party. See *Qualified Disclaimers*, under *Gift Tax*.

Deemed Transferor's Marital Deduction

For the estate of a person who died before 1982, the estate tax marital deduction is figured using the following adjustment.

If the generation-skipping transfer occurs at the same time as, or within 9 months after the death of the deemed transferor, the value of the gross estate of the deemed transferor is considered to be increased by the value of the amount of the generation-skipping transfer for the purpose of computing the marital deduction in the deemed transferor's estate.

Any increase in the amount of the marital deduction by reason of a generation-skipping transfer occurring after the death of the decedent (deemed transferor) is not to be treated as a terminable interest solely by reason of the fact that the maximum amount of the deduction is not known as of the date of death.

Income Tax

Where certain rights to income are subject to the tax on generation-skipping transfers, and the income is also subject to the income tax, the recipient of this income (whether the trustee or a beneficiary of the trust) is entitled to a deduction in computing the income tax on this income. Generally, the deduction for the generation-skipping tax is figured in the same way as the recipient of ***income in respect of a decedent*** would figure a deduction for estate tax. See Publication 559, *Tax Information for Survivors, Executors, and Administrators*, for an explanation of computing the estate tax deduction.

Redemption of Stock to Pay Death Taxes

If corporate stock is subject to the generation-skipping transfer tax as a result of a transfer that occurs at, or after, the deemed transferor's death, and a redemption of stock so transferred occurs (to pay death taxes), then:

1) The stock is deemed to be included in the gross estate of the deemed transferor,
2) The estate, inheritance, legacy, and succession taxes (including any interest collected as part of such taxes) that are imposed because of the generation-skipping transfer are treated as being imposed because of the deemed transferor's death and for purposes of redemptions to pay death taxes rules, the generation-skipping transfer tax is treated as an estate tax,
3) The distribution period begins on the date of the generation-skipping transfer, and
4) The relationship between the corporate stock and the decedent's estate is measured with reference solely to the amount of the generation-skipping transfer.

The trust and the actual estate of the deemed transferor are to be treated separately for purposes of the stock redemptions to pay death taxes qualification requirements.

Redemptions to pay death taxes are discussed in *Stock Redemptions to Pay Estate Taxes*, under *Estate Tax*.

Basis Adjustment

If ***before the death*** of a deemed transferor, property is transferred to any person pursuant to a generation-skipping transfer, the basis of the transferred property in the transferee's hands is increased (not above the fair market value of the property) by an amount equal to that portion of the generation-skipping tax that is attributable to the excess of the fair market value of the transferred property over its adjusted basis immediately before the transfer.

If ***at the same time as, or after, the death*** of a deemed transferor, property is transferred to any person pursuant to a generation-skipping transfer, the basis of the transferred property is adjusted in a manner similar to that required for property acquired from a decedent. See *Basis—Property Acquired from a Decedent*, under *Estate Tax*.

Requests for Factors, Computations, and Rulings

If a factor, computation, or ruling is necessary to complete a tax return, you may request assistance by writing to the Internal Revenue Service, Associate Chief Counsel (Technical), CC: IND: EA, 1111 Constitution Avenue, Washington, DC 20224.

The National Office issues rulings on transactions affecting the estate tax of a decedent before the estate tax return is filed. A ruling may be issued after a return is filed, if the request for a ruling was made before the return was filed. Attach a copy of the ruling request to the estate tax return. The National Office will not rule on matters relating to the application of the estate tax to property or the estate of a living person.

In matters involving the additional estate tax on special-use valuation property, the National Office issues rulings on prospective transactions and on completed transactions before the return is filed for those transactions.

In gift tax matters, the National Office issues rulings on prospective transactions and completed transactions before the return is filed for them.

The National Office issues rulings on transactions affecting the generation-skipping transfer tax before the return is filed. Rulings will not be issued until after the generation-skipping trust (or trust equivalent) has been established. Rulings will not be issued on a generation-skipping transfer tax matter before the distribution or termination takes place. The National Office will issue rulings regarding the application of the effective date rules to wills, trusts, and trust equivalents in existence on June 11, 1976.

Information for Requests

You should submit a request for a ruling in duplicate if more than one issue is presented in the request, or if a closing agreement is requested on the issue presented. Each request must contain the following items:

1) The names, addresses, and taxpayer identifying numbers of all interested parties.
2) A carefully detailed description of the transaction.
3) The location of the district office that has or will have jurisdiction over the return.
4) True copies of all contracts, wills, deeds, agreements, instruments, and other documents involved in the transaction. (Original documents should not be submitted because they become part of the Service file and will not be returned.)
5) If you furnish material facts to the Service by telephone or orally at a conference, you must promptly confirm them by letter to the Service, along with a declaration in the form described later in this section. This confirmation must be furnished within 21 calendar days to be considered part of your request.
6) A statement whether, to the best of your knowledge, the identical issue is in a return of the taxpayer, or of a related taxpayer (within the meaning of section 267 of the Code), and if so, whether the issue:
   a) Is under examination by a District Director,
   b) Has been examined and the statutory period of limitations on assessment or refund of tax has not expired or a closing agreement has not been entered into by a District Director,
   c) Is under consideration by an Appeals office in connection with a return of the taxpayer for an earlier period, or that issue has been considered by an Appeals office and the statutory period of limitations has not expired or a closing agreement has not been entered into by an Appeals office, or
   d) Is pending in litigation in a case involving the taxpayer or a related taxpayer.
7) A statement whether, to the best of your knowledge, the identical or similar issue has been ruled on by the Service and, if so, when and with what results. (If after the request is filed but before the ruling is issued you are aware that an examination of the issue has been started by the District Director, you must notify the National Office of such action. If you file the return before receiving the ruling from the National Office, you must attach a copy of the request to the return.)
8) If you assert a particular determination, you must furnish an explanation of the grounds for your assertion, together with a statement of relevant authorities in support of your views. Even though you are not urging a particular determination of a proposed or prospective transaction, you must state your views as to the tax results of the proposed action and the relevant authorities to support such views.
9) You are encouraged to inform the Service of, and discuss the implication of, any legislation, or tax treaties, court decisions, regulations, revenue rulings, or revenue procedures that you determine are contrary to the position that you advance. If you determine that there are no contrary authorities, you should make a statement to this effect in your ruling request. This information may help the Service to make a determination and avoid delays in issuing a ruling.
10) If your request involves an actuarial factor, you must furnish the names, dates of birth, and sex of all involved parties along with a narrative statement of any contingencies that are not adequately described in the instrument(s) submitted under item (4).
11) If you are requesting the computation of the tax due involving an interrelated computation you must furnish sufficient supporting data to enable the Service to make the computation. For most estates, copies of the will and relevant trust instruments, a schedule of assets and deductions, and a tentative computation of state taxes should accompany the request.
12) A copy of the request and of supporting documents on which are indicated, in brackets, those portions you suggest be deleted from the text of rulings, which are open to public inspection. In lieu of those copies, a statement may be submitted indicating that no deletions need be made except names, addresses, and taxpayer identifying numbers.
13) A statement, made in a separate document, in support of the deletions suggested, indicating the statutory basis under section 6110(c) of the Code that applies to each bracketed portion. See *Exemptions from Disclosure*.
14) The request must be signed by the taxpayer or the taxpayer's authorized representative. Form 2848, *Power of Attorney and Declaration of Representative*, and Form 2848-D, *Tax Information Authorization and Declaration of Representative*, may be used for a ruling request.
15) A declaration signed by the person or persons on whose behalf the request for a ruling is made, in the following form: "Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and, to the best of my knowledge and belief, the facts presented in support of the requested ruling are true, correct, and complete."

NOTE. For more information about the procedures to be followed to promote efficient handling of your request, you should refer to Revenue Procedure 82-37.

Exemptions from Disclosure

Section 6110(c) of the Internal Revenue Code of 1954 is as follows:

(c) Exemptions From Disclosure—Before making any written determination or background file document open or available to public inspection under subsection (a), the Secretary shall delete—
   (1) the names, addresses, and other identifying details of the person to whom the written determination pertains and of any other person, other than a person with respect to whom a notation is made under subsection (d)(1), identified in the written determination or any background file document;
   (2) information specifically authorized under criteria established by an Executive order to be kept secret in the interest of national defense or foreign policy, and which is in fact properly classified pursuant to such Executive order;
   (3) information specifically exempted from disclosure by any statute (other than this title) which is applicable to the Internal Revenue Service;
   (4) trade secrets and commercial or financial information obtained from a person and privileged or confidential;
   (5) information the disclosure of which would constitute a clearly unwarranted invasion of personal privacy;
   (6) information contained in or related to examination, operating, or condition reports prepared by, or on behalf of, or for use of an agency responsible for the regulation or supervision of financial institutions; and
   (7) geological and geophysical information and data, including maps, concerning wells.

The Secretary shall determine the appropriate extent of such deletions and, except in the case of intentional or willful disregard of this subsection, shall not be required to make such deletions (nor be liable for failure to make deletions) unless the Secretary has agreed to such deletions or has been ordered by a court (in a proceeding under subsection (f)(3)) to make such deletions.

Unified Rate Schedule

Taxable amount equal to or more than— (1)	Taxable amount less than— (2)	Tax on amount in column (1) (3)	Rate of tax on excess over amount in column (1) (4)
			(Percent)
0	10,000	0	18
10,000	20,000	1,800	20
20,000	40,000	3,800	22
40,000	60,000	8,200	24
60,000	80,000	13,000	26
80,000	100,000	18,200	28
100,000	150,000	23,800	30
150,000	250,000	38,800	32
250,000	500,000	70,800	34
500,000	750,000	155,800	37
750,000	1,000,000	248,300	39
1,000,000	1,250,000	345,800	41
1,250,000	1,500,000	448,300	43
1,500,000	2,000,000	555,800	45
2,000,000	2,500,000	780,800	49
2,500,000	Use the following tables for the year in which the decedent died or in which a gift was made.		
	1981		
2,500,000	3,000,000	1,025,800	53
3,000,000	3,500,000	1,290,800	57
3,500,000	4,000,000	1,575,800	61
4,000,000	4,500,000	1,880,800	65
4,500,000	5,000,000	2,205,800	69
5,000,000	.....	2,550,800	70
	1982		
2,500,000	3,000,000	1,025,800	53
3,000,000	3,500,000	1,290,800	57
3,500,000	4,000,000	1,575,800	61
4,000,000	.....	1,880,800	65
	1983		
2,500,000	3,000,000	1,025,800	53
3,000,000	3,500,000	1,290,800	57
3,500,000	.....	1,575,800	60
	1984		
2,500,000	3,000,000	1,025,800	53
3,000,000	.....	1,290,800	55
	1985 and later		
2,500,000	.....	1,025,800	50

Maximum Credit for State Death Taxes (Based on federal adjusted taxable estate which is the federal taxable estate reduced by $60,000)			
Adjusted taxable estate equal to or more than— (1)	Adjusted taxable estate less than— (2)	Credit on amount in column (1) (3)	Rates of credit on excess over amount in column (1) (4)
			Percent
0	$40,000	0	None
$40,000	90,000	0	0.8
90,000	140,000	$400	1.6
140,000	240,000	1,200	2.4
240,000	440,000	3,600	3.2
440,000	640,000	10,000	4.0
640,000	840,000	18,000	4.8
840,000	1,040,000	27,600	5.6
1,040,000	1,540,000	38,800	6.4
1,540,000	2,040,000	70,800	7.2
2,040,000	2,540,000	106,800	8.0
2,540,000	3,040,000	146,800	8.8
3,040,000	3,540,000	190,800	9.6
3,540,000	4,040,000	238,800	10.4
4,040,000	5,040,000	290,800	11.2
5,040,000	6,040,000	402,800	12.0
6,040,000	7,040,000	522,800	12.8
7,040,000	8,040,000	650,800	13.6
8,040,000	9,040,000	786,800	14.4
9,040,000	10,040,000	930,800	15.2
10,040,000	.....	1,082,800	16.0

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How to Get IRS Forms and Publications

The publications mentioned in this document contain additional information that can help you understand your tax responsibilities. You can order publications and tax forms from the IRS Forms Distribution Center for your state at the address below. Many public libraries keep copies of some reproducible tax forms that you may photocopy—on the spot.

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Puerto Rico—Director's Representative, U.S. Internal Revenue Service, Federal Office Building, Chardon Street, Hato Rey, PR 00918

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